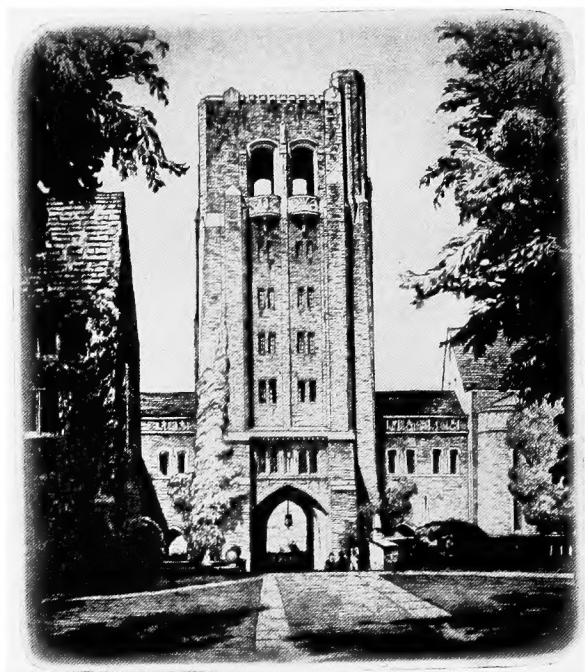


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A TREATISE  
ON THE  
LAW OF INTERCORPORATE RELATIONS





A  
TREATISE ON THE LAW  
OF  
INTERCORPORATE RELATIONS

BY  
WALTER CHADWICK NOYES  
UNITED STATES CIRCUIT JUDGE FOR THE SECOND CIRCUIT  
AUTHOR OF "AMERICAN RAILROAD RATES"

SECOND EDITION  
REVISED AND ENLARGED

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DEDICATED  
TO THE MEMORY OF THE  
HONORABLE AUGUSTUS BRANDEGEE  
AS A TRIBUTE TO A LAWYER WHO BY  
HIS LEARNING, BRILLIANCY, HIGH  
IDEALS AND ACHIEVEMENTS  
HONORED HIS PROFESSION



## PREFACE TO SECOND EDITION

THE development during the past six years of the law upon the subjects examined in this treatise has rendered a new edition necessary. This development has been most marked in the law relating to legislation against combinations, and the last six chapters which embrace this subject have been almost wholly rewritten. Consequently, while the section arrangement of the first edition has been elsewhere retained, it has been found necessary to abandon it in those chapters. References to the first edition, therefore, apply to this edition in all but the last six chapters.

The purpose of this treatise is to examine exhaustively a limited number of important subjects. Only in so far as it may furnish the practitioner adequate information concerning the law existing upon any of the phases of those subjects does it fulfil its purpose.

W. C. N.

NEW YORK,  
October 28, 1908





## PREFACE TO FIRST EDITION

THE modern tendency of business is toward concentration and coöperation instead of competition. The modern instrument of business is the corporation. The development of the tendency through the instrument has resulted in the joining together, in varying forms, of corporate entities and properties. Corporate conjunction involves intercorporate relations, and the legal questions growing out of these relations furnish the subject-matter of this treatise.

The preparation of the first four parts of this work has been a process of amplification; of the last part, a process of reduction. The conjunction of corporate entities through consolidation, of corporate properties through sales and leases, and the concentration of corporate control through holding shares, are outlined in general treatises upon corporation and railroad law. The material for the development of the subjects, in a manner commensurate with their importance, has, however, only been found through a systematic examination of original sources.

The law governing combinations of corporations is more accessible, but less adaptable. The value of a mass of apparently conflicting decisions appears only when it is reduced to principles. In collecting the cases much assistance has been derived from the general treatises upon monopolies and similar subjects. Especial acknowledgment is due to Mr. Eddy's valuable work upon combinations of labor and capital ("Combinations"), although its underlying theory that a combination of capital, to be unlawful, must be a conspiracy, is essentially different from that of the present treatise. The theory of this treatise is that the validity of a combination depends upon considerations of public policy. Rules of public policy are formulated, and an attempt is made to deduce from the cases collected principles of general application. No con-

## PREFACE TO FIRST EDITION

sideration is, however, given to labor combinations and other subjects examined in the general treatises.

The statutes of all the American States and many English statutes, governing the various relations of corporations, are collected in footnotes; and the cases, where numerous, are arranged under the names of the respective States. By this plan, it is believed that the statute and case law of each State may be readily found.

With hardly a single exception, each citation has been carefully verified with the original report, the date of the opinion inserted, and parallel references added.

A treatise of this nature, prepared amid the distractions incident to the performance of other duties, cannot be free from fault. But while the conclusions may not always follow from the premises, and the theories may have no foundation at all, it is hoped that the work will be found accurate in stating and referring to the decisions of the courts. And whatever measure of accuracy it may possess is due, in no inconsiderable degree, to the diligence of Mr. Frank L. McGuire, of the New London (Conn.) bar, who has verified the references and prepared the Table of Cases.

W. C. N.

LYME, CONNECTICUT,  
September 1, 1902.

# CONTENTS

	PAGE
§§ 1-6. PRELIMINARY . . . . .	3

## PART I

### CONSOLIDATION OF CORPORATIONS

#### CHAPTER I

##### NATURE OF CONSOLIDATION

§ 7. Term "Consolidation" of Uncertain Meaning . . . . .	11
8. Uses of the Term distinguished . . . . .	13
9. Consolidation as a Result and as a Process . . . . .	15
10. An Analogy in the Civil Law . . . . .	16
11. Merger . . . . .	16
12. Amalgamation . . . . .	17
13. Distinction between Consolidation and Sale . . . . .	18
14. Distinction between Consolidation and Lease . . . . .	21
15. Distinction between Consolidation and Control . . . . .	22
16. Distinction between Consolidation and Combination . . . . .	23

#### CHAPTER II

##### LEGISLATIVE AUTHORITY FOR CONSOLIDATION

###### I. *Necessity for Legislative Authority*

§ 17. Consolidation without Legislative Authority <i>ultra vires</i> . . . . .	24
18. Consolidation of <i>Quasi</i> -public Corporations without Legislative Authority against Public Policy . . . . .	26

###### II. *Conferring and Withdrawal of Legislative Authority*

19. Power of Legislature to authorize Consolidation . . . . .	27
19a. Authorization of Consolidation of Interstate Railroads not Regulation of Interstate Commerce . . . . .	29
20. Legislative Sanction — How expressed . . . . .	31
21. Public Policy regarding Consolidation of Non-competing Railroads . . . . .	32
22. What Railroads may consolidate — Statutory Provisions . . . . .	33
23. What Business Corporations may consolidate — Statutory Provisions . . . . .	41
24. Power of Legislature to withdraw or limit Right to consolidate — (A) In Absence of Reserved Power . . . . .	44
25. Power of Legislature to withdraw or limit Right to consolidate — (B) In Exercise of Reserved Power . . . . .	46
26. Power of Legislature to withdraw or limit Right to consolidate — (C) In Exercise of Police Power . . . . .	46

## CONTENTS

	<i>III. Construction of Statutes authorizing Consolidation</i>	PAGE
§ 27.	General Rules of Construction . . . . .	47
28.	Construction of Particular Statutory Provisions . . . . .	50
29.	Construction of Statutes authorizing Consolidation of Railroads — Connecting or Continuous Lines . . . . .	52
30.	Construction of Statues authorizing Consolidation of Corporations other than Railroads . . . . .	56

## CHAPTER III

### CONSTITUTIONAL AND STATUTORY RESTRAINTS UPON CONSOLIDATION

§ 31.	Public Policy regarding Consolidation of Competing Railroads . .	58
32.	Constitutional and Statutory Provisions against Consolidation of Competing Railroads . . . . .	60
33.	Construction of Prohibitions — (A) Meaning of Term "Consolida- tion" . . . . .	64
34.	Construction of Prohibitions — (B) Whether a Lease amounts to Consolidation . . . . .	66
35.	Construction of Prohibitions — (C) Arrangements amounting to Consolidation . . . . .	67
36.	Construction of Prohibitions — (D) Control of Competing Railroads by Holding Corporation . . . . .	69
37.	Construction of Prohibitions — (E) What are Competing or Parallel Railroads . . . . .	72
38.	Prohibition of Consolidation of Competing Railroads not a Regu- lation of Interstate Commerce . . . . .	74
39.	Constitutional Prohibitions against Consolidation of Competing Carrier Corporations other than Railroads . . . . .	76
40.	Enforcement of Provisions against Consolidation of Competing Lines . . . . .	77

## CHAPTER IV

### ASSENT OF STOCKHOLDERS

§ 41.	Requisite Number of Stockholders — (A) Under Laws in Force at Organization of Consolidating Corporations . . . . .	78
42.	Requisite Number of Stockholders — (B) When Unanimous Con- sent is necessary . . . . .	80
43.	Requisite Number of Stockholders — (C) Under Enactments in Exercise of Reserved Power . . . . .	84
44.	Power of Legislature to compel Consolidation under its Reserved Power . . . . .	86
45.	Assent of Stockholders — How manifested. Acquiescence. Estoppel . . . . .	88
46.	Rights and Remedies of Dissenting Stockholders . . . . .	90
47.	Rights and Remedies of Dissenting Subscribers . . . . .	92
48.	Procedure in Stockholders' Actions . . . . .	94
49.	Laches of Stockholders . . . . .	95
50.	Can a Majority effect Consolidation upon giving Security to Dissent- ing Stockholders? . . . . .	96
51.	The Right to condemn Stock . . . . .	98

## CONTENTS

### CHAPTER V

#### METHOD OF CONSOLIDATION

	PAGE
§ 52. Formal Statutory Requisites . . . . .	100
53. When Consolidation is effected . . . . .	106
54. Construction of Statutes prescribing Mode of Consolidation . . . . .	106
55. What Statutory Provisions Conditions Precedent . . . . .	108
56. What Statutory Provisions not Conditions Precedent . . . . .	109
57. Statutory Provisions for Appraisal of Stock . . . . .	111

### CHAPTER VI

#### EFFECT OF CONSOLIDATION UPON STATUS OF CONSOLIDATING CORPORATIONS AND THEIR STOCKHOLDERS

§ 58. Effect of Consolidation may be Fusion, Merger, or Continued Existence . . . . .	113
59. Effect of Consolidation depends upon Terms of Consolidation Act . . . . .	114
60. As a General Rule, Effect of Consolidation is Creation of New Corporation and Dissolution of Constituents . . . . .	115
61. Exceptions to the Rule — Merger and Continuance of Corporations . . . . .	118
62. Construction of Particular Consolidation Acts. Cases showing Creation of Distinct Corporation . . . . .	120
63. Construction of Particular Consolidation Acts. Cases of Absorption or Merger . . . . .	122
64. Effect of Valid Consolidation upon Stockholders of Constituent Corporations . . . . .	123

### CHAPTER VII

#### RIGHTS AND POWERS OF CONSOLIDATED CORPORATION

##### *I. Statutory Transmission of Property, Franchises, and Privileges*

§ 65. General Rule. Legal Presumption . . . . .	126
66. Real Estate and Rights in Streets . . . . .	129
67. Choses in Action . . . . .	131
68. Subscriptions . . . . .	132
69. Enforcement of Subscriber's Obligations. Conditional Subscriptions . . . . .	133
70. Municipal Aid . . . . .	135
71. Constitutional Limitations upon Grants of Privileges and Immunities . . . . .	137
72. Exemptions from Taxation . . . . .	138
73. Special Privileges and Immunities other than Tax Exemptions . . . . .	142

##### *II. Powers*

74. Powers of Consolidated Corporation. In General . . . . .	143
75. Power to issue Mortgage Bonds . . . . .	144
76. Right of Eminent Domain . . . . .	145
77. Miscellaneous Powers . . . . .	146

## CONTENTS .

### CHAPTER VIII

#### OBLIGATIONS OF CONSOLIDATED CORPORATION

##### I. *Direct Obligations*

	PAGE
§ 78. Constitutional Limitations . . . . .	149
78a. Consolidated Corporation liable upon its Own Obligations . . . . .	150
79. As a General Rule Consolidated Corporation directly assumes all Obligations of Constituents . . . . .	150
80. Obligation to perform Public Duties of Constituents . . . . .	154
81. Liability of Consolidated Company to Bondholders and Preferred Stockholders of Constituents. Other Special Contracts . . . . .	156
82. Liability for Torts of Constituents . . . . .	159
83. Rule of Liability inapplicable to Consolidation after Foreclosure Sale . . . . .	161

##### II. *Liens*

84. Conventional and Statutory Liens . . . . .	162
85. Equitable Liens . . . . .	163

##### III. *Remedies of Creditors of Constituent Corporations*

86. Remedy of Creditors against Consolidated Corporation — At Law . . . . .	165
87. Remedy of Creditors — In Equity . . . . .	167
88. Remedy against Constituent Corporation if not dissolved . . . . .	168
89. Effect of Consolidation upon Pending Suits . . . . .	170
90. Procedure regarding Pending Suits . . . . .	171
91. Allegation and Proof of Consolidation . . . . .	172

### CHAPTER IX

#### IRREGULAR AND INVALID CONSOLIDATIONS

§ 92. Attempted Consolidation — <i>Status</i> of Resulting Organization . . . . .	174
93. Effect of Unlawful Consolidation . . . . .	176
94. Effect of Irregular Consolidation . . . . .	177
95. Who may attack Irregular Consolidation . . . . .	178
96. Estoppel to deny Regularity of Consolidation . . . . .	180
97. Accounting after Attempted Consolidation . . . . .	183
98. Fraud in Consolidation Agreement . . . . .	183

### CHAPTER X

#### INTERSTATE CONSOLIDATIONS

§ 99. Consolidation of Corporations of Different States — How authorized . . . . .	186
100. Construction of Interstate Consolidation Statutes . . . . .	186
101. <i>Status</i> of Interstate Consolidated Corporation . . . . .	187
102. Effect of Interstate Consolidation upon <i>Status</i> of Constituent Corporations . . . . .	192
103. Management of Interstate Consolidated Corporation . . . . .	193
104. Rights and Powers of Interstate Consolidated Corporation . . . . .	194
105. Duties of Interstate Consolidated Corporation — Taxation . . . . .	195
106. Citizenship of Interstate Consolidated Corporation . . . . .	196
107. Foreclosure of Mortgages after Interstate Consolidation. Jurisdiction . . . . .	199



## CONTENTS

# PART II

## CORPORATE SALES

### ARTICLE I

#### SALES OF CORPORATE PROPERTY AND FRANCHISES

### CHAPTER XI

#### SALES OF CORPORATE PROPERTY

##### I. *Sales of Property of Private Corporations*

	PAGE
§ 108. Power to purchase and sell generally . . . . .	202
109. Sale of Entire Corporate Property by Unanimous Consent . . . . .	203
110. Sale of Entire Property of Prosperous Corporation by Majority Vote . . . . .	205
111. Sale of Entire Property of Losing Corporation by Majority Vote . . . . .	210
112. Sale of Entire Corporate Property by Directors . . . . .	211
113. Ratification by Stockholders of Sale by Directors . . . . .	213
114. Remedies of Dissenting Stockholders in Case of Invalid or Unfair Sales . . . . .	215
115. Procedure in Stockholders' Actions . . . . .	221
116. Defences to Stockholders' Actions. Estoppel . . . . .	223
117. Effect of Sale of Entire Corporate Property . . . . .	226

##### II. *Exchange of Property of One Corporation for Stock of Another*

118. Transfer of Entire Corporate Property without Unanimous Con- sent requires Monetary Consideration . . . . .	227
119. Exchange of Property for Stock <i>ultra vires</i> . . . . .	227
120. Exchange of Property for Stock Infringement of Rights of Dis- senting Stockholders . . . . .	229
121. Appraisal of Stock of Dissenting Stockholders . . . . .	232
122. Stock received upon Exchange belongs primarily to Corporation . . . . .	234
122a. Effect of Execution of <i>Ultra Vires</i> Contract for Exchange of Prop- erty for Stock . . . . .	236
122b. Remedies of Dissenting Stockholders in Case of Exchange of Prop- erty for Stock . . . . .	237

##### III. *Rights and Remedies of Creditors*

123. Liability of Purchasing Corporation for Debts of Vendor Company . . . . .	237
124. Fraudulent Sales . . . . .	243
125. Remedies of Creditors . . . . .	247
126. Priority of Purchaser's Mortgage over Claims of Vendor's Creditors . . . . .	251

##### IV. *Sales of Property of Quasi-public Corporations*

127. Indispensable Property cannot be alienated or taken on Execution without Statutory Authority . . . . .	252
128. Test of Indispensability . . . . .	254
129. Sales of Surplus Property . . . . .	255
129a. <i>Ultra Vires</i> Sales of Property of Private and <i>Quasi</i> -public Corpora- tions . . . . .	256

## CONTENTS

### CHAPTER XII

#### SALES OF CORPORATE FRANCHISES

##### I. *Transferability of Franchises*

	PAGE
§ 130. Nature of a Franchise . . . . .	261
131. Franchise of Corporate Existence . . . . .	262
132. Transferability of Franchise of Corporate Existence . . . . .	264
133. Franchises of Corporations . . . . .	265
134. Transferability of Franchises of Corporations . . . . .	270

##### II. *Legislative Authority for Sale of Franchises*

135. Legislative Authority essential to Alienation of Franchises . . .	271
136. Unauthorized Sale of Franchises — <i>Ultra Vires</i> . . . . .	272
137. Unauthorized Sale of Franchises — Against Public Policy . . .	273
138. Unauthorized Sale of Franchises — Unlawful Delegation of Powers .	274
139. Legislative Authority essential to Purchase of Franchises . . .	275
139a. <i>Ultra Vires</i> Sales of Franchises . . . . .	277

### ARTICLE II

#### SALES OF RAILROADS

### CHAPTER XIII

#### CONTRACT OF SALE AND ITS EXECUTION

##### I. *Nature of Sale of Railroad*

§ 140. Conventional and Judicial Sales of Railroads distinguished . . .	278
141. Distinction between Relation of Vendor and Vendee and other Intercompany Relations . . . . .	278
142. Distinction between Sale of Railroad and Sale of Franchises . . .	279

##### II. *Grants of Power to sell and purchase Railroads*

143. Statutory Authority essential to Sale of Railroad . . . . .	280
144. Seller must have Authority to sell and Buyer to buy . . . . .	281
145. What Railroads may be the Subject of Sale. Statutory Provisions .	282
146. Construction of Statutes . . . . .	289
147. Constitutional and Statutory Prohibitions of Purchase of Compet- ing or Parallel Lines . . . . .	291

##### III. *Authorization and Execution of Contract of Sale*

148. Statutory Requisites . . . . .	292
149. Assent of Stockholders. Whether Approval of Majority is suffi- cient . . . . .	293
150. Acquiescence of Stockholders . . . . .	296
151. Rights and Remedies of Dissenting Stockholders . . . . .	296

### CHAPTER XIV

#### EFFECT OF EXECUTION OF CONTRACT OF SALE

##### I. *Rights and Liabilities of Vendor Corporation*

§ 152. Sale of Railroad and Franchises does not terminate Corporate Existence . . . . .	299
--	-----

## CONTENTS

	PAGE
§ 153. Rights of Vendor Corporation after Authorized Sale . . . . .	300
154. Liabilities of Vendor Corporation in Case of Authorized Sale . . .	301
155. Liabilities of Vendor Corporation in Case of Unauthorized Sale . .	301
156. <i>Quo Warranto</i> and other Proceedings against Vendor Corporation .	302

### II. *Rights and Liabilities of Vendee Corporation*

157. Essential Franchises pass upon Sale of Railroad . . . . .	302
158. Rights and Powers of Vendee Corporation — In General . . . .	303
159. Right of Eminent Domain . . . . .	304
160. Exemptions from Taxation . . . . .	304
161. Right to fix Rates of Fare. Chartered Rates . . . . .	306
162. Obligations of Vendee Corporation in respect of Public Duties of Vendor . . . . .	307
163. Vendee Corporation not liable upon Obligations of Vendor unless assumed or imposed by Law . . . . .	308
164. <i>Status</i> of Foreign Purchasing Corporation . . . . .	311

## PART III

### CORPORATE LEASES

#### ARTICLE I

#### CHAPTER XV

##### LEASES OF CORPORATE PROPERTY AND FRANCHISES

###### I. *Leases of Property of Private Corporation*

§ 165. Power to lease and take a Lease generally . . . . .	312
166. Lease of Entire Property of Prosperous Corporation . . . . .	314
167. Lease of Entire Property of Losing Corporation . . . . .	316
168. Voidable Leases . . . . .	317
169. Remedies of Objecting Stockholders . . . . .	319

###### II. *Leases of Property and Franchises of Quasi-public Corporations*

170. Distinction between Leases of Private and <i>Quasi-public</i> Corporations . . . . .	320
171. Leases of Indispensable Property of <i>Quasi-public</i> Corporation . .	320
172. Leases of Surplus Property . . . . .	320
173. Leases of Franchises . . . . .	322
174. Railroad Leases typical of Leases of <i>Quasi-public</i> Corporations .	322

#### ARTICLE II

##### LEASES OF RAILROADS (INCLUDING TRACKAGE CONTRACTS)

#### CHAPTER XVI

##### NATURE AND AUTHORIZATION OF CONTRACT OF LEASE

###### I. *Nature of Lease of Railroad*

§ 175. What constitutes a Lease of a Railroad . . . . .	323
176. Distinction between Relation of Lessor and Lessee and other Inter-corporate Relations . . . . .	326

## CONTENTS

	PAGE
<i>II. Legislative Authority for Lease of Railroad</i>	
§ 177. Lease of Railroad invalid without Legislative Authority . . .	326
178. Necessity for Legislative Authority to take a Lease . . .	329
179. Legislative Ratification of Unauthorized Lease . . .	329
180. What Railroads may be leased. Statutory Provisions . . .	331
181. Rule of Construction of Statutes . . .	334
182. Construction of Statutes — (A) Provisions authorizing Leases .	335
183. Construction of Statutes — (B) Provisions not authorizing Leases	338
184. Construction of Statutes — (C) Power to lease Unfinished Road .	341
185. Construction of Statutes — (D) Leases of Connecting Lines . .	342
186. Constitutional and Statutory Prohibitions of Leases of Competing or Parallel Lines . . .	343
187. Long Term Leases not prohibited by Statutes against Perpetuities	343

## CHAPTER XVII

### APPROVAL AND EXECUTION OF CONTRACT OF LEASE

<i>I. Assent of Stockholders to Railroad Lease</i>	
§ 188. Necessity for Consent of Stockholders to Lease of Railroad. Power of Directors . . .	344
189. Whether Unanimous Consent is necessary unless otherwise pro- vided . . .	346
190. Requisite Majority prescribe Terms of Lease . . .	348
191. Remedies of Dissenting Stockholders . . .	349
192. Acquiescence and Laches of Stockholders . . .	350
<i>II. Method of approving and executing Railroad Leases</i>	
193. Statutory Requirements . . .	353
194. Construction of Statutes prescribing Mode of approving and exe- cuting Leases . . .	354
195. Formalities attending Execution of Lease of Railroad . . .	356
196. Corporation may be estopped from alleging Irregular Execution of Lease . . .	359

## CHAPTER XVIII

### THE CONTRACT OF LEASE

<i>I. Form and Construction of Railroad Leases</i>	
§ 197. Form of Lease . . .	360
198. Consideration . . .	361
199. Rules of Construction of Leases . . .	361
200. Construction of Particular Leases . . .	362
201. Lease for Longer Term than Existence of Corporations may be valid . . .	364
202. Partial Invalidity of Leases. Void Restrictions . . .	365
203. Dependent and Independent Contracts . . .	366
203a. Assignments of Leases . . .	367
<i>II. Covenants in Railroad Leases</i>	
204. Covenant to pay Rent. Assumption of Interest Payments . .	368
205. Covenant to pay Taxes . . .	370
206. Covenant not to assign . . .	372
207. Covenant to make Repairs . . .	374

## CONTENTS

	PAGE
§ 208. Covenant to pay Damages and defend Suits . . . . .	375
209. Miscellaneous Covenants . . . . .	376

## CHAPTER XIX

### RIGHTS AND LIABILITIES OF LESSOR CORPORATION

#### *I. Rights and Remedies of Lessor Corporation*

§ 210. Lessor Corporation retains Prerogative Powers — Right of Eminent Domain . . . . .	377
211. Rights of Lessor when entitled to Share of Earnings — Equitable Lien . . . . .	379
212. Rights of Stockholders when Rent is payable in Form of Dividends . . . . .	381
213. Mortgage of Rent Charge . . . . .	383
214. Remedies of Lessor Corporation . . . . .	383

#### *II. Liabilities of Lessor Corporation*

215. Obligations of Lessor Corporation to State . . . . .	385
216. Lessor Corporation cannot avoid Statutory Obligations unless exempted . . . . .	386
217. Lessor cannot avoid Primary Obligations unless exempted . . . . .	389
218. Liability of Lessor for Negligent Operation of Railroad — (A) Under Unauthorized Lease . . . . .	392
219. Liability of Lessor for Negligent Operation of Railroad — (B) Under Authorized Lease . . . . .	393
220. Liability of Lessor for Negligent Operation of Railroad — (C) To Employees of Lessee . . . . .	400
221. Liability of Lessor for Negligent Operation of Railroad — (D) When it shares in Control . . . . .	403
222. Liability of Lessor upon Contracts of Lessee . . . . .	404
223. Liability of Lessor for Reconstruction and Repairs . . . . .	405
224. Taxation of Leased Railroads . . . . .	406

## CHAPTER XX

### RIGHTS AND LIABILITIES OF LESSEE CORPORATION

#### *I. Rights and Remedies of Lessee Corporation*

§ 225. Rights of Lessee in General. Incidental Franchises . . . . .	409
226. Rights of Lessee in Matter of Tolls . . . . .	410
227. Mortgages of Leases . . . . .	411
228. Remedies of Lessee Corporation . . . . .	412

#### *II. Liabilities of Lessee Corporation*

229. Obligation of Lessee to perform Lessor's Public Duties . . . . .	412
230. Statutory Liability of Lessee . . . . .	414
231. Liability of Lessee for Torts in Operation of Road under Authorized or Unauthorized Lease . . . . .	417
232. Joint Liability of Lessor and Lessee . . . . .	419
233. Liability of Lessee for Debts of Lessor . . . . .	421

## CONTENTS

### CHAPTER XXI

#### RAILROAD LEASES UNDER RECEIVERSHIP

	PAGE
§ 234. Receiver not Assignee of the Term. May not abrogate Leases as between Parties . . . . .	422
235. Receiver may elect within Reasonable Time to assume or renounce Lease . . . . .	424
236. Obligations of Receiver pending Election . . . . .	426
237. Obligations of Receiver after Election . . . . .	429
238. Lease of Railroad by Receiver . . . . .	431

### CHAPTER XXII

#### ULTRA VIRES AND VOIDABLE RAILROAD LEASES

§ 239. Distinction between <i>Ultra Vires</i> and Irregular Leases . . . .	432
240. Enforcement of Executory <i>Ultra Vires</i> Leases . . . . .	434
241. Delivery of Possession under <i>Ultra Vires</i> Lease . . . . .	435
242. Right and Duty of Disaffirmance . . . . .	437
243. Recovery of Property after Disaffirmance . . . . .	438
244. Recovery on <i>Quantum Meruit</i> for Past Use . . . . .	440
245. Improvements made by Lessee under <i>Ultra Vires</i> Lease . . . .	443
246. Effect of <i>Ultra Vires</i> Lease upon Stock Subscriptions . . . .	444
247. Guarantee of <i>Ultra Vires</i> Lease void . . . . .	444
248. Voidable Railroad Leases . . . . .	445
249. Leases of Railroads for Purpose of suppressing Competition . .	448
250. Remedy of State — <i>Quo Warranto</i> . . . . .	448
251. Remedy of State — Injunction . . . . .	449

### CHAPTER XXIII

#### LEASES TO FOREIGN CORPORATIONS

§ 252. Authority to lease must be derived from State where Railroad is located . . . . .	451
253. Authority to lease to Foreign Corporation . . . . .	453
254. <i>Status</i> of Foreign Corporation leasing Railroad . . . . .	454

### CHAPTER XXIV

#### TRACKAGE CONTRACTS

§ 255. Nature of a Trackage Contract . . . . .	455
256. Express Authority not necessary for Execution of Trackage Contract . . . . .	457
257. Execution of Trackage Contracts . . . . .	459
258. Assignability of Trackage Contracts . . . . .	460
259. Construction of Trackage Contracts . . . . .	461
260. Specific Performance of Trackage Contracts . . . . .	464
261. Liability of Proprietary Company to Third Persons . . . . .	466
262. Liability of Licensee Company to Third Persons . . . . .	468
263. Liability to Employees . . . . .	470

## CONTENTS

### PART IV

#### CORPORATE STOCKHOLDING AND CONTROL

##### CHAPTER XXV

###### POWER OF CORPORATION TO HOLD STOCK IN OTHER CORPORATIONS

###### *I. Rule that Statutory Authority is essential*

		PAGE
§ 264.	Necessity for Statutory Authority to purchase Stock. Rule in United States . . . . .	473
265.	Necessity for Statutory Authority to purchase Stock. Rule in England . . . . .	475
266.	Necessity for Statutory Authority to subscribe for Stock . . . .	476
267.	Subscriptions or Purchases through Trustees or Agents . . . .	478
268.	Similar Nature of Corporations does not affect application of Rule	479
269.	Expediency of Purchase of Stock immaterial . . . . .	481
270.	Assumption of Power to hold Stock in Articles of Association . .	482

###### *II. Express Power to acquire Stock*

§ 271.	Corporations may acquire Stock in other Corporations when authorized. Statutory Provisions . . . . .	483
272.	Power to subscribe for Stock in Foreign Corporations . . . .	491
273.	Construction of Statutes . . . . .	492
274.	Construction of Constitutional Prohibitions . . . . .	497

###### *III. Incidental Power to acquire Stock*

275.	In General . . . . .	499
276.	Incidental Power to make Investments in Stocks . . . . .	500
277.	Incidental Power to take Stock in Satisfaction of Debt . . . .	501
278.	Incidental Power to take Stock as Collateral . . . . .	504
279.	Incidental Power to acquire Stock in Connection with Consolidation or Purchase . . . . .	505
280.	Incidental Power to take Stock upon a Reorganization . . . .	507
281.	Incidental Power to take Stock in Exchange for Corporate Assets	507
282.	Miscellaneous Instances of Incidental Power to acquire Stock .	508
283.	Presumption of Power to hold Stock . . . . .	510
283a.	An Analogous Power . . . . .	510

##### CHAPTER XXVI

###### RIGHTS AND OBLIGATIONS OF CORPORATION AS STOCK- HOLDER

###### *I. Intra Vires Holdings*

§ 284.	Status of Corporation holding Stock . . . . .	516
285.	Nature of "Holding Corporations" . . . . .	517
286.	Rights of Foreign Corporation holding Stock . . . . .	519
287.	Incidents of Ownership attach to <i>Intra Vires</i> Holdings . . . .	523
287a.	Collateral Trust Bonds . . . . .	525

## CONTENTS

### II. *Ultra Vires* Holdings

	PAGE
§ 288. What Incidents of Ownership attach to <i>Ultra Vires</i> Holdings . . . . .	529
288a. Status of Parties to <i>Ultra Vires</i> Purchases of Stock . . . . .	530
289. Liability for Assessments upon <i>Ultra Vires</i> Holdings . . . . .	532
290. <i>Ultra Vires</i> Contracts for Purchase of Stock. Who may question Validity of <i>Ultra Vires</i> Purchases. Dependent Contracts . . . . .	535
291. Independent Contracts . . . . .	536
292. Holding Stock to prevent Competition . . . . .	538
293. Remedies in Case of <i>Ultra Vires</i> Stockholding . . . . .	539

## CHAPTER XXVII

### CONTROL OF ONE CORPORATION BY ANOTHER

§ 294. Meaning of Term "Control" . . . . .	542
295. Distinction between Control of Corporation and Control of its Property . . . . .	543
296. Distinction between Control and Community of Interest . . . . .	544
297. Distinction between Control and Consolidation . . . . .	545
298. Power to purchase Stock to obtain Control . . . . .	545
299. Status of Corporations as Controlling Stockholders . . . . .	547
300. Trust Relation of Controlling Corporation to Minority Stock- holders . . . . .	547
301. Remedies of Minority Stockholders of Controlled Corporation . . . . .	550

## PART V

### COMBINATIONS OF CORPORATIONS

#### ARTICLE I

#### COMBINATIONS AS AFFECTED BY PRINCIPLES OF CORPORATION LAW

### CHAPTER XXVIII

#### NATURE AND FORMATION OF COMBINATIONS

§ 302. Definition of Term "Combination" . . . . .	552
303. Definition of Term "Association" . . . . .	553
304. Definition of Term "Trust" . . . . .	554
305. Popular Use of Word "Trust" . . . . .	554
306. Definition of Phrase "Corporate Combination" . . . . .	555
307. Evolution of the Combination . . . . .	556
308. Formation of Associations . . . . .	557
309. Formation of Trusts . . . . .	559
310. Formation of Corporate Combinations . . . . .	560
311. Analysis of Principles determining Legality of Combinations . . . . .	561

## CHAPTER XXIX

#### PRINCIPLES OF CORPORATION LAW AFFECTING ASSOCIATIONS AND TRUSTS

§ 312. Legality of Associations not generally a Question of Corporation Law . . . . .	562
--	-----



## CONTENTS

	PAGE
§ 313. In Formation of Trust, State regards Acts of Stockholders as Acts of Corporation . . . . .	562
314. Trust invalid as involving Partnership of Corporations . . . .	564
315. Trust invalid as involving Delegation of Corporate Powers . .	566
316. Trust invalid as involving Practical Consolidation . . . . .	567
317. Rights and Liabilities growing out of Trusts . . . . .	569

## CHAPTER XXX

### PRINCIPLES OF CORPORATION LAW AFFECTING CORPORATE COMBINATIONS

§ 318. Corporate Combinations by means of Purchasing Corporations — In General . . . . .	570
319. Issue of Stock for Property in Formation of Corporate Combination . . . . .	571
320. Issue of Stock for Good-will in Formation of Corporate Combination . . . . .	573
321. Over-valuation of Property acquired by Issue of Stock . . . .	575
322. Power of Vendor Corporations to sell Properties for Stock of Purchasing Corporation . . . . .	577
323. Corporate Combinations through Formation of Holding Corporations . . . . .	577

## ARTICLE II

### COMBINATIONS AS AFFECTED BY PRINCIPLES OF COMMON LAW AND PUBLIC POLICY

## CHAPTER XXXI

### APPLICATION OF LAW OF CONSPIRACIES

§ 324. Definition and Classification of Conspiracies . . . . .	578
325. Criminal and Civil Conspiracies distinguished . . . . .	580
326. Applicability of Law of Conspiracies to Corporations . . . .	581
327. What Combinations are Conspiracies . . . . .	583
327a. Remedies and Procedure in Case of Conspiracies . . . . .	587
328. Modern Combinations of Capital seldom Conspiracies . . . .	590

## CHAPTER XXXII

### APPLICATION OF LAW OF MONOPOLIES

§ 329. Primary Meaning of Term "Monopoly" . . . . .	593
330. Growth of Monopolies — Their Illegality . . . . .	593
331. No True Monopolies in United States. Patents and other <i>Quasi-Monopolies</i> . . . . .	595
332. Modern Use of Term "Monopoly" . . . . .	597
333. Direct Test of Validity of Combination not whether it is a Monopoly . . . . .	601

## CHAPTER XXXIII

### APPLICATION OF LAW OF CONTRACTS IN RESTRAINT OF TRADE

§ 334. Definition and Nature of "Contract in Restraint of Trade" . .	602
335. Connection between Contracts in Restraint of Trade and Corporate Combinations . . . . .	603

## CONTENTS

	PAGE
§ 336. Modern Use of Phrase "Contract in Restraint of Trade" . . . . .	605
337. Direct Test of Validity of Combination not whether it is in Restraint of Trade . . . . .	608

## CHAPTER XXXIV

### FORMULATION OF RULES OF PUBLIC POLICY

§ 338. Definition and Nature of Public Policy . . . . .	609
339. Necessity for Rules of Public Policy . . . . .	611
340. Difficulty of Formulating Rules of Public Policy concerning Com- binations . . . . .	612
341. Formulation of Rules. Basis in Judicial Decisions . . . . .	613
342. Basis of Rules — (A) Case of the Sugar Trust . . . . .	613
343. Basis of Rules — (B) Case of the Standard Oil Trust . . . . .	616
344. Basis of Rules — (C) Whiskey Trust Cases . . . . .	618
345. Basis of Rules — (D) Case of the Preservers Trust . . . . .	620
346. Basis of Rules — (E) Case of the Chicago Gas Trust . . . . .	621
347. Basis of Rules — (F) Case of the Diamond Match Company . . . . .	623
348. Basis of Rules — (G) Case of the Glucose Combination . . . . .	625
348a. Basis of Rules — (H) Case of the Pocahontas Coke Company . . . . .	627
349. Basis of Rules — (I) Miscellaneous Cases . . . . .	631

## CHAPTER XXXV

### RULES OF PUBLIC POLICY

§ 350. In General . . . . .	633
351. Distinction between Rules of Public Policy applicable to Private and <i>Quasi</i> -public Corporations . . . . .	634
352. Rules . . . . .	634
353. Rules Conservative Standards . . . . .	634
354. Analysis of Rule governing Private Corporations — (A) Form of Combination immaterial . . . . .	635
355. Analysis of Rule — (B) Objects and Tendencies of Combinations . . . . .	639
356. Analysis of Rule — (C) Control of the Market . . . . .	642
357. Analysis of Rule — (D) Extent of Territory . . . . .	647
358. Analysis of Rule — (E) Useful Commodities . . . . .	648
359. Analysis of Rule of Public Policy applicable to <i>Quasi</i> -public Corporations . . . . .	653

## CHAPTER XXXVI

### APPLICATION OF RULES OF PUBLIC POLICY TO PARTICULAR CLASSES OF COMBINATIONS

§ 360. Associations of Manufacturers and Producers . . . . .	654
361. Associations of Manufacturers owning Patents . . . . .	658
362. Associations of Dealers . . . . .	658
363. Associations of Railroad Companies — (A) Traffic Contracts of Connecting Lines . . . . .	659
364. Associations of Railroad Companies — (B) Traffic Contracts of Competing Lines . . . . .	661
364a. Associations of Railroad Companies — (C) Pools . . . . .	662
365. Associations of Gas Companies and other <i>Quasi</i> -public Corpora- tions . . . . .	664

## CONTENTS

### CHAPTER XXXVII

#### RIGHTS AND REMEDIES

	PAGE
§ 366. Rights and Remedies of Members of Illegal Combinations. In General . . . . .	667
367. Rights and Remedies between Combination and its Members . . . . .	669
368. Rights of Receivers and Assignees . . . . .	671
369. Collateral Attack upon Combination. Remedies upon Independent Contracts . . . . .	672
370. Rights of Creditors . . . . .	676
371. Rights and Remedies of Stockholders of Combining Corporations . . . . .	677
372. Remedies of State — (A) <i>Quo Warranto</i> against Corporate Combination . . . . .	680
373. Remedies of State — (B) <i>Quo Warranto</i> against Combining Corporations . . . . .	682
374. Remedies of State — (C) Injunction . . . . .	684
375. Evidence . . . . .	686

### ARTICLE III

#### LEGISLATION AFFECTING COMBINATIONS

##### I

#### FEDERAL ANTI-TRUST STATUTE

### CHAPTER XXXVIII

#### THE STATUTE AND ITS CONSTITUTIONALITY

§ 376. The Statute . . . . .	688
377. Analysis of Statute . . . . .	689
378. Object of Statute . . . . .	691
379. Constitutionality of Act — (A) Power of Congress under Commerce Clause to legislate concerning Private Contracts affecting Interstate Commerce . . . . .	692
380. Constitutionality of Act — (B) Power of Congress under Commerce Clause to legislate concerning Contracts and Combinations under State Laws . . . . .	694
381. Constitutionality of Act — (C) Power of Congress under Commerce Clause to prohibit Combinations of Competing Railroads . . . . .	696
382. Constitutionality of Act — (D) Act is Constitutional . . . . .	697
383. Legislation supplementing the Statute — (1) Anti-trust provisions of Wilson Tariff Act . . . . .	698
384. Legislation supplementing the Statute — (2) The Expedition Act . . . . .	698
385. Legislation supplementing the Statute — (3) The Immunity Proviso . . . . .	699

### CHAPTER XXXIX

#### CONSTRUCTION AND APPLICATION OF FEDERAL STATUTE

§ 386. Title of Statute . . . . .	700
387. Use of Phrase "Contract in Restraint of Trade." Application of Statute of Ancillary Contracts . . . . .	701

## CONTENTS

	PAGE
§ 388. Statute not limited to Unreasonable Restraint of Trade . . .	705
389. Use of Terms "Monopolize" and "Monopolies" . . . . .	709
390. Meaning of Phrase, "Trade or Commerce among the Several States" . . . . .	714
391. Statute applies only to Restraints upon Interstate or International Commerce . . . . .	716
392. Restraint upon Interstate Commerce must be Direct — (A) In General . . . . .	717
393. Restraint upon Interstate Commerce must be Direct — (B) Combinations relating to Manufacture and of Manufacturers and Producers . . . . .	719
394. Restraint upon Interstate Commerce must be Direct — (C) Restraints upon Facilities for Commerce . . . . .	726
395. Restraint upon Interstate Commerce must be Direct — (D) Exchange and Similar Associations . . . . .	728
396. Restraint may be imposed upon those engaged in Interstate Commerce by those not engaged therein . . . . .	729
397. Form of Combination immaterial. Illegality of Corporate Device	730
397a. The Northern Securities Case . . . . .	731
398. Application of Statute of Combinations of Railroads and other carriers. Combinations of Railroad Employees . . . . .	734
399. Application of Statute of Combinations under Patents . . . . .	739
400. Application of Statute to Combinations under Copyrights . . . . .	742
401. Application of Statute to Combinations under Secret Processes . . . . .	743
402. Application of Statute to Contracts concerning Market Quotations	745
403. Application of Statute to State's Monopoly and State Regulations	745
404. Statute not Retroactive but applies to Continuing Combinations . . . . .	746

## CHAPTER XL

### RIGHTS, REMEDIES AND PROCEDURE UNDER FEDERAL STATUTE

§ 405. Invalidity under Federal Statute as a Ground of Collateral Attack . . . . .	746
406. Proceedings in Equity by Government. Injunctive Relief. Parties . . . . .	749
407. Criminal Proceedings. Indictments. Parties . . . . .	751
408. Actions by Government to enforce Forfeiture . . . . .	753
409. Actions for Treble Damages. Pleadings . . . . .	754
410. Limitations of Actions . . . . .	758
411. Effect of Voluntary Dissolution of Combination pending proceeding . . . . .	758
412. Proof of Violation of Statute. Evidence . . . . .	759
413. Interpretation of Immunity Proviso . . . . .	761

## II

### STATE ANTI-TRUST STATUTES

## CHAPTER XLI

### STATE STATUTES AND THEIR CONSTITUTIONALITY

§ 414. The Statutes. Development of State Legislation . . . . .	762
415. Sphere of State Legislation. Operation of Commerce Clause of the Constitution . . . . .	783
416. Controlling Propositions in determining Constitutionality of State Statutes . . . . .	784

## CONTENTS

	PAGE
§ 417. Power of State to prohibit Combinations of <i>Quasi</i> -public Corporations. Power over Property devoted to Public Uses . . . . .	785
418. Power of State to prohibit Combinations of Corporations in Exercise of Reserved Power . . . . .	787
419. Validity of State Statutes tested by Fourteenth Amendment — (A) Right to Contract . . . . .	788
420. Validity of State Statutes tested by Fourteenth Amendment — (B) Police Power of the State . . . . .	791
421. Validity of State Statutes tested by Fourteenth Amendment — (C) Class Legislation . . . . .	797
422. Validity of State Statutes under State Constitutional Provisions .	802
423. State Courts' Interpretation of State Statute followed by Federal Courts in determining its Constitutionality . . . . .	805
424. Who may question Constitutionality of Statutes . . . . .	806

## CHAPTER XLII

### CONSTRUCTION AND APPLICATION OF STATE ANTI-TRUST STATUTES

§ 425. Definitions . . . . .	807
426. Statutes not Regulations of Interstate Commerce . . . . .	809
427. Rule of Construction . . . . .	810
428. Form of Combination Immaterial. Application of Statutes to Holding and Purchasing Corporations . . . . .	811
429. Objects and Tendencies of Combination as determining Application of Statutes . . . . .	813
430. Extent of Combination as determining Application of Statutes .	815
431. Application of Statutes to Ancillary Contracts in Restraint of Trade . . . . .	816
432. Application of Statutes to Agency and other Exclusive and Restrictive Contracts. Sales and Leases . . . . .	817
433. Application of Statutes to Particular Associations of Manufacturers and Dealers . . . . .	820
434. Application of Statutes to Combinations under Patents and Copyrights . . . . .	823
435. Application of Statutes to Insurance Combinations . . . . .	823
436. Application of Statutes to Foreign Corporations doing Local Business . . . . .	825
437. Statutes have no Extraterritorial Force . . . . .	827
438. Application of Statutes to Agreements of <i>Quasi</i> -public Corporations . . . . .	829
439. Effect of Statutes upon Exercise of Statutory Authority to consolidate or hold Stock . . . . .	830
440. Statutes inapplicable to Contracts with State . . . . .	832
441. Statutes inapplicable where other Statutes eliminate Competition .	832
442. Statutes do not supersede Common Law . . . . .	832
443. Statutes not Retroactive but apply to Continuing Combinations .	833
444. Construction and Application of Miscellaneous Statutes . . . . .	834

## CHAPTER XLIII

### RIGHTS, REMEDIES AND PROCEDURE UNDER STATE ANTI-TRUST STATUTES

§ 445. Contracts in Violation of Statutes unenforceable. Independent Contracts. Invalidity under Statutes as Ground of Collateral Attack . . . . .	836
--	-----

# CONTENTS

	PAGE
§ 446. Criminal Proceedings. Indictments . . . . .	840
447. Proceedings to enforce Forfeitures . . . . .	844
448. Proceedings against Corporations . . . . .	846
449. Actions for Damages . . . . .	847
450. Evidence. Production of Books . . . . .	850
451. Statutes of Limitation . . . . .	851
INDEX . . . . .	853

# TABLE OF CASES

(References are to pages.)

A	PAGE	PAGE
Abbott v. American Hard Rubber Co.	212, 216	American Handle Co. v. Standard Handle Co. 672, 839, 843, 849, 850
v. Johnstown, etc. Horse R. Co.	25, 327, 392	American Loan, etc. Co. v. Minnesota, etc. R. Co. 26, 27, 33, 49, 175, 176, 181, 187
v. New York, etc. R. Co.	128, 145, 146, 265	American Preservers Trust v. Taylor Mfg. Co. 565, 566, 620, 651, 670
v. Omaha Smelting, etc. Co.	262	American Railway-Frog Co. v. Haven Green 514
Abby v. Billups	313, 376	American Soda Fountain Co. v. Green 675
Abeles v. Cochrane	511	American Strawboard Co. v. Peoria Strawboard Co. 657, 667, 838
Acker v. Alexandria, etc. R. Co.	301	American Tube, etc. Co. v. Hayes 576
Ackerman v. Cincinnati, etc. R. Co.	390, 397	American Water Works Co. v. Venner 537
Adams v. Yazoo, etc. R. Co.	27, 44	Ames v. Union Pacific R. Co. 423, 425, 428
Addyston Pipe, etc. Co. v. United States	606, 642, 643, 693, 697, 702, 715, 716, 717, 720, 722, 723	Ammant v. New Alexandria Turnpike Co. 254, 255
Adelbert University v. Toledo, etc. R. Co.	181, 187	Anchor, etc. Mfg. Co. v. Hawkes 604
Adler v. Fenton	581	Anderson v. Jett 644
Admiral, The	162	v. Philadelphia Warehouse Co. 525
Ætna Ins. Co. v. Albany, etc. R. Co.	370, 382	v. Shawnee Compress Co. 606, 656
v. Commonwealth	824	v. United States 718, 727, 728
Africa v. Knoxville	129	v. Union Terminal R. Co. 386
Albers, C. H., Commission Co. v. Spencer	822, 850	Angier v. East Tennessee, etc. R. Co. 197, 311
Alderman v. People	579	Anglo-American Land, etc. Co. v. Lombard 205, 473, 494, 530, 545
Aldnut v. Inglis	787	Anglo-Italian Bank, <i>In re</i> 112
Alexander v. Railway Co.	80, 83	Anheuser Busch Brew. Ass'n v. Houck 641, 650, 652, 673
v. Relfe	249	Anthony v. American Glucose Co. 235
v. Searcy	223, 225, 540, 541, 551	v. Campbell 251
Alford v. Chicago, etc. R. Co.	463	Appeal Tax Court v. Western Maryland R. Co. 408
Alger v. Thatcher	604	Arbuckle v. Illinois Midland R. Co. 166, 168
Altenburgh v. Grant	576	
Altoona, etc. R. Co. v. Beech Creek R. Co.	457	
American, etc. Co. v. Linn	550	
American Biscuit, etc. Co. v. Klotz	569, 607, 631, 650, 670, 711	
American Brake Beam Co. v. Pungs	604	
American Fire Ins. Co. v. State	824, 852	

# TABLE OF CASES

	PAGE		PAGE
Archer v. Terre Haute, etc. R. Co.	15, 22, 325	Badische Anilin und Soda Fabrik v. Schott	605
Ardesco Oil Co. v. North American Oil, etc. Co.	203, 213, 313	Bagshaw v. Eastern Union R. Co.	216
Arkansas Midland R. Co. v. Berry	305	Bailey v. Citizens Gas Light Co.	183
Armstrong v. Karschner	300	v. Master Plumbers' Ass'n	791,
v. Toler	674	795, 822	
Arnot v. Pittston, etc. Coal Co.		v. Philadelphia	597
650, 658, 673, 676		v. Railroad Co.	155
Arrowsmith v. Nashville, etc. R. Co.	390, 391, 392, 397, 418	Baker v. Harpster	242
Arthur v. Commercial Railroad Bank	280	Baldwin v. Canfield	504
Ashbury Carriage, etc. Co. v. Riche	257, 433, 434	Ball Electric Light Co. v. Child	525
Ashhurst's Appeal	226	Balliet v. Brown	212, 215
Ashley v. Ryan	75, 109, 190	Balsley v. St. Louis, etc. R. Co.	388, 394
Aspinwall v. Ohio, etc. R. Co.	193	Baltimore, etc. R. Co. v. Musselman	12, 171
Assessors v. Morris, etc. R. Co.	305	v. Paul	402
Atchison, etc. R. Co. v. Cochran	496	v. Pausch	408
v. Davis	496	v. Wabash R. Co.	418
v. Denver, etc. R. Co.	51, 659, 660	v. Worker	417
v. Fletcher	496, 507	Baltimore, etc. Tel. Co. v. Western Union Tel. Co.	666
v. Phillips County	80, 136	Baltimore v. Baltimore, etc. R. Co.	493
Atkinson v. Marietta, etc. R. Co.	264	Bancroft & Sons Co. v. Bloede	474
Atlanta, etc. R. Co. v. State	121, 362	Bank of Augusta v. Earle	261, 262
Atlantic, etc. R. Co. v. Allen	140, 306	Bank of Commerce v. Hart	480, 496
v. St. Louis	32	v. Tennessee	44
Atlantic, etc. Tel. Co. v. Union Pacific R. Co.	321, 323	Bank of Hindustan, Higg's Case, <i>In re</i>	18, 19
Atlantic Ave. R. Co. v. Johnson	152	Bank of Long Island v. Young	129
Attorney General v. A. Booth & Co.	684, 794, 812, 826, 846, 847	Bank of Middlebury v. Edgerton	265
v. Chicago, etc. R. Co.	450	Bank of San Luis Obispo v. Wick-ersham	511
v. Delaware, etc. R. Co.	450	Bank v. Lanier	514
v. Great Eastern R. Co.	450, 458	v. Smith	380, 430
v. Great Northern R. Co.	450, 685	Banks v. Georgia, etc. R. Co.	402
v. Jamaica Pond Aqueduct	450	v. Judah	225, 247
v. Mid-Kent R. Co.	450	Barataria Canning Co. v. Jouliau	808, 820
v. North-Eastern Ry.	144	Barber v. International, etc. Co.	243, 248
v. Reynolds	450	Barbier v. Connolly	790
v. Tudor Ice Co.	449	Barclay v. Quicksilver Min. Co.	249
v. Utica Ins. Co.	449	Barley v. Southern R. Co.	291
Austin v. Seligman	382	Barnard v. Norwich, etc. R. Co.	412
v. Tecumseh National Bank	242	Barnard's Banking Co., <i>In re</i>	475
Aycock v. Raleigh, etc. R. Co.	388, 467	Barnett v. Philadelphia Market Co.	91, 97, 112
Ayles v. South Eastern R. Co.	467	Barr v. Bartram, etc. Mfg. Co.	247
Axline v. Toledo, etc. R. Co.	388	v. New York, etc. R. Co.	220, 446, 547, 572
		Barrie v. United Rys. Co.	238, 241, 242, 246
B		Barrows v. People's Gas Light, etc. Co.	50
Babcock v. Schuykill, etc. R. Co.	125	Barry v. Merchants Exch. Co.	203
Backus v. Detroit, etc. R. Co.	390	Bartholomew v. City of Austin	597



## TABLE OF CASES

	PAGE		PAGE
Bartholomew v. Derby Rubber Co.	316	Bigelow v. Calumet, etc. Mining Co.	750, 755, 812
Bartlett v. Drew	239	Bingham v. Brands	794, 819
v. Fourton	511, 514	Binney's Case	203
Barto v. Nix	512	Birchfield v. Northern Central R. Co.	415
Barton v. Enterprise, etc. Ass'n	208	Bird v. Bird's Patent Deodorizing, etc. Co.	216
v. Mulvane	839	Birmingham, etc. Co. v. Freeman	213
v. Port Jackson Road Co.	512, 514	Birmingham R., etc. Co. v. Elsen	151, 170
Bates County v. Winters	136	Bish v. Johnson	79, 80, 133
Bath Gas Light Co. v. Claffy	323, 434, 441, 442	Bishop v. American Preservers Co.	565, 566, 569, 620, 651, 670, 755, 756, 826
Batterson v. Grand Trunk R. Co.	160	v. Brainerd	32, 88, 100, 119, 133, 188, 192
Baxter v. Nashville, etc. Turnpike Co.	254, 255	Black v. Delaware, etc. Canal Co.	6, 25, 26, 27, 47, 48, 50, 53, 82, 85, 97, 98, 99, 187, 208, 231, 253, 289, 317, 327, 328, 335, 336, 454
v. New York, etc. Co.	402	Blair v. City of Chicago	258
Beal v. Chase	604	v. St. Louis, etc. R. Co.	244, 252
v. Essex Savings Bank	525	Blake v. Domestic Mfg. Co.	243, 528
Bean v. Atlantic, etc. R. Co.	388	v. Winona, etc. R. Co.	266
Bear River Orchard Co. v. Hanley	535	Blalock v. Kernersville Mfg. Co.	513
Beard v. Denis	604	Blanc v. Paymaster Min. Co.	248
Bedford R. Co. v. Bowser	345	Blanchard Gun Stock, etc. Factory v. Warner	202
Beebe v. Hatfield	573	Blatchford v. Ross	25, 80, 90, 95, 212, 221
v. Richmond Light, etc. Co.	355	Blindell v. Hagan	750
Beecher v. Marquette, etc. R. Co.	351	Block v. Standard Distilling Co.	750
Beechley v. Mulville	669, 824	Blodgett v. Lanyon Zinc Co.	203
Beekman v. Hudson River, etc. R. Co.	411	Bloxham v. Metropolitan R. Co.	223
Beggs v. Edison El. Light, etc. Co.	57	Blue Rapids Opera House Co. v. Mercantile Bldg., etc. Ass'n	508
Beling v. American Tobacco Co.	95, 125	Bhundell's Case	18
Bell, <i>In re</i>	803	Boardman v. Lake Shore, etc. R. Co.	31, 125, 157
Bell v. American Protective League	423, 425, 428	Board of Trade v. Christie Grain, etc. Co.	745
v. Pennsylvania R. Co.	96, 182	Bobbs-Merrill Co. v. Straus	743
Bellerby v. Rowland	511	Bohn Mfg. Co. v. Hollis	580
Beman v. Rufford	216, 222, 274, 458	Bonsack Mach. Co. v. Smith	675
Bement v. National Harrow Co.	704, 740, 748, 750	Booe v. Junction R. Co.	92
Benbow v. Cook	203	Boon v. City of Utica	597
Benedict v. Heineberg	255	Boor v. Tolman	175
v. Western Union Tel. Co.	666	Booth v. Clark	422
Benesh v. Mill Owners Mut., etc. Ins. Co.	242	v. Robinson	476
Berger v. United States Steel Corp'n	513	Boston, etc. Min. Co. v. Montana Ore-Purchasing Co.	210
Berlin Machine Works v. Perry	605	Boston, etc. R. Co. v. Boston, etc. R. Co.	50, 187, 291, 366, 372, 373, 383, 384, 461
Berry v. Broach	211, 224	v. Gilmore	255
v. Kansas City, etc. R. Co.	152, 160, 166	v. Graham	352
v. Yates	477, 478, 480		
Beveridge v. New York Elevated R. Co.	338, 344, 382		
Bickley v. Schlag	576		
Bienville Water Supply Co. v. City of Mobile	598		
Bigbee, etc. Packet Co. v. Moore	530, 537		

# TABLE OF CASES

	PAGE		PAGE
Boston, etc. R. Co. v. New York, etc. R. Co.	49, 88, 208, 216, 225, 226, 230, 296, 347, 352, 434, 508	Brum v. Merchants Mut. Ins. Co.	152, 248
Boston, etc. R. Corp. v. Midland R. Co.	128, 146	Bruner v. Brown	571, 576
Botts v. Simpsonville, etc. Turn- pike Road Co.	81, 85, 90, 95	Brunswick Gas Light Co. v. United Gas, etc. Co.	255, 271, 323, 434, 437, 440, 441, 442, 443
Bouknight v. Charlotte, etc. R. Co.	392	Buck v. Ross	239
Bowden v. Johnson	525	Buck Mountain Coal Co. v. Le- high Coal, etc. Co.	450
Bower v. Burlington, etc. R. Co.	392, 403, 415	Buckley v. Big Muddy Iron Co.	217
Bowman v. Foster, etc. Co.	508	Buckner v. Richmond, etc. R. Co.	402
Boynton v. Roe	213	Buckwalter v. Whipple	245, 250
Braceville Coal Co. v. People	788	Budd v. New York	786
Bradford v. Frankfort, etc. R. Co.	89, 107, 110, 182	Buell v. Buckingham	203, 211, 213
Bramlet v. Commonwealth Land, etc. Co.	244	Buffalo, etc. R. Co., <i>In re</i> v. Dudley	494 84
Branch v. Atlantic, etc. R. Co.	88, 163, 291	Buffalo Lubricating Oil Co. v. Standard Oil Co.	582
v. Charleston	141	Buford v. Keokuk, etc. Packet Co.	231, 508
v. Jesup	51, 178, 256, 270, 280, 303, 571	Bull v. Baltimore, etc. R. Co.	170
Brant v. Ehlen	572, 576	Burden v. Burden	510
Braslin v. Somerville Horse R. Co.	327, 395	Burge v. St. Louis, etc. R. Co.	308
Brenham v. Water Co.	596, 597	Burger v. Grand Rapids, etc. R. Co.	189, 191, 193
Brennan v. United Hatters	673	Burke v. Cleveland, etc. R. Co.	53, 107
Brett v. Ebel	605, 704	Burkinshaw v. Nichols	572
Brewster v. Hartley	514	Burnes v. Burnes	513
v. Miller's Sons Co.	586, 848	Burr v. Pittsburg, etc. R. Co.	224
Brickerhoff v. Brown	226	Burrows v. Interborough-Metro- politan Co.	831
Bridgeport v. New York, etc. R. Co.	262, 269, 280	Butler v. Rahen	365
Briscoe v. Southern Kansas R. Co.	253, 337, 340, 392, 452, 453	Button v. Hoffman	516
British Nation, etc. Ass'n, <i>Ex</i> <i>parte</i>	532	Byrne v. Schuyler Electric Mfg. Co.	206, 216, 225, 229, 231, 473, 480, 507, 508
Brockway Mfg. Co., <i>In re</i>	239	C	
Brooklyn, etc. R. Co., <i>In re</i>	365	Cain v. City of Wyoming	268
v. Long Island R. Co.	341	v. Syracuse, etc. R. Co.	466
Brooklyn Distilling Co. v. Stand- ard Distilling Co.	820, 837	Caledonian, etc. R. Co. v. Magis- trates of Helensburgh	434
Brooker v. Maysville, etc. R. Co.	336, 392	Caledonian R. Co. v. North Brit- ish R. Co.	457
Brooks v. Cooper	610	California v. Central Pacific R. Co.	262
Brown v. Dibble	134, 173, 179	California Bank v. Kennedy	473, 480, 504, 505, 532, 533, 534
v. Duluth, etc. R. Co.	225	California Central R. Co. v. Hooper	146, 170
v. Hannibal, etc. R. Co.	389	Callahan v. Donnolly	604
v. Jacobs' Pharmacy Co.	578, 589, 590, 642, 643, 652, 765, 798	Callaway v. Foster	136
v. Toledo, etc. R. Co.	423, 428	Calumet Paper Co. v. Haskell	
v. Winnisimmet Co.	321	Show Printing Co.	213
Brufett v. Great Western R. Co.	161, 226, 238, 299		

# TABLE OF CASES

	PAGE		PAGE
Calumet Paper Co. v. Stotts In- vest. Co.	504, 525	Central, etc. R. Co. v. Perry v. Pettus	466 248
Camden, etc. R. Co. v. May's Landing R. Co.	275, 336, 435, 442	v. Phinazee	392, 394
Camden v. Stuart	573	v. Smith	566
Camden Interstate R. Co. v. Lee	249, 310	v. State	116
Camden Safe Deposit, etc. Co. v. Burlington Carpet Co.	110, 145	Central Branch Union Pacific R. Co. v. Western Union Tel. Co.	324
Cameron v. Havemeyer	569, 570, 614	Central Electrical Co. v. Sprague Electrical Co.	243
v. New York, etc. Water Co.	46, 56	Central Ohio Salt Co. v. Guthrie	599,
Campbell v. Farmers, etc. Bank	238	632, 641, 645, 651, 655	
v. Marietta, etc. R. Co.	150, 290, 307	Central R. Co. v. Brinson	394
Canada Life Assur. Co. v. Pell Mfg. Co.	475	v. Macon	53
Canal, etc. R. Co. v. St. Charles Street R. Co.	461	v. Pennsylvania R. Co.	477, 478, 479, 519, 520
Cannon v. Brush Electric Co.	548	v. Pettus	421
Cantlon v. Eastern R. Co.	416	Central R., etc. Co. v. Collins	59, 94, 216, 473, 479, 481, 538, 539, 677
Canton v. Canton, etc. Co.	409	Central Shade Roller Co. v. Cush- man	559, 651, 654, 686, 742
Capital City Light, etc. Co. v. City of Tallahassee	597	Central Transportation Co. v. Pullman Car Co.	24, 253, 255, 259, 275, 327, 329, 334, 335, 340, 351, 432, 434, 436, 437, 438, 439, 440, 441, 443, 536
Capital Traction Co. v. Offut	19, 238, 309	Central Trust Co. v. Continental Trust Co.	423, 425, 430
Carey v. Cincinnati, etc. R. Co.	116, 182	v. Colo. Midland R. Co.	456, 468
Carr v. Le Fevre	576	v. Denver, etc. R. Co.	466
v. Rochester Tumbler Co.	224	v. Kneeland	528
Carrol v. Greenwich Ins. Co.	797, 825, 826	v. Ohio Cent. R. Co.	663
Carson v. Iowa, etc. Co.	216	v. Rochester, etc. R. Co.	197
Carston v. Hofins	242	v. Wabash, etc. R. Co.	423, 430, 431, 465
Carswell v. Farmers Loan, etc. Co.	423, 425, 426, 428	v. Washington Co. R. Co.	290
Carter v. Producers, etc. Oil Co.	212, 496	v. Western North Carolina R. Co.	263
Carter-Crume Co. v. Peurrung	637, 657, 676	Central University v. Walter	14, 52, 87
Cartwright v. Dickinson	511	Chamberlain v. Bromberg	213
Caruthers v. Kansas City, etc. R. Co.	397	Chapin v. Brown	599, 648, 650, 658, 667
Case of the Monopolies	622	Chapman v. Douglass County	440, 441
Cashman v. Brownlee	129	v. Ironclad Rheostat	513
Cass v. Manchester, etc. R. Co.	314, 345	v. Mad River, etc. R. Co.	82, 95
Castle Bread Co., <i>In re</i>	513, 514	Chappell v. Brockway	602, 645
Catawissa R. Co. v. Philadelphia, etc. R. Co.	376	Charity Hospital v. New Orleans Gas Light Co.	116, 118, 155
Catskill Bank v. Gray	676	Charles E. Wiswall, The	747
Ceballos v. Munson Steamship Line	708	Charles River Bridge v. Warren Bridge	269, 334
Central, etc. Co. v. Farmers Loan, etc. Co.	381, 429, 431	Charleston v. Branch	141
Central, etc. R. Co. v. Morris	328, 341, 405	Charlotte, etc. R. Co. v. Gibbes	116, 143, 155
v. Georgia	11, 14, 17, 114, 118, 123, 128, 137, 138, 141	Charlotte First Nat. Bank v. Charlotte	92
		v. National Exch. Bank	502, 503, 504
		Charlton v. Newcastle, etc. R. Co.	27, 459

# TABLE OF CASES

	PAGE		PAGE
Chase v. Michigan Tel. Co.	19, 22	Chicago, etc. R. Co. v. Third	
v. Tuttle	213	National Bank	421
v. Vanderbilt	148, 157	v. Union Pacific R. Co.	322
Chatham v. Newcastle, etc. R.		v. Wabash, etc. R. Co.	26, 653, 663
Co.	663	v. Weber	359, 409
Chattanooga, etc. R. Co. v.		Chicago City R. Co. v. People	267, 268
Evans	241, 244, 245, 250	Chicago Gas Light, etc. Co. v.	
Chattanooga Foundry, etc.		People's Gas Light, etc. Co.	323, 654, 665
Works v. City of Atlanta	757, 758	Chicago Hansom Cab Co. v.	
Chattanooga Terminal R. Co. v.		Yerkes	216, 217, 219, 223
Felton	379	Chicago Mun. Gas Light v.	
Chemical Nat. Bank v. Have-		Lake	266
meyer	534	Chicago St. R. Co. v. Marseilles	513
Cheraw, etc. R. Co. v. Anson	116	Chicago Wall Paper Mills v. Gen-	
Chesapeake, etc. Fuel Co. v.		eral Paper Co.	838, 839
United States	707, 724	Chollette v. Omaha, etc. R. Co.	273, 301, 395
Chesapeake, etc. R. Co. v. Griest	238, 308, 309, 310	Chouteau v. Dean	572
v. Miller	161, 305, 306	Cilley v. United Shoe Mach. Co.	578
v. Osborne	392	Cincinnati, etc. R. Co. v. Bunnell	387, 415
v. Virginia	141	v. Indiana, etc. R. Co.	362
Chester Nat. Bank v. Atlanta,		v. McKeen	536
etc. R. Co.	396, 405	v. Paskins	468
Chewaca Lime Works v. Dis-		v. Townsend	468
mukes	259	Cincinnati Packet Co. v. Bay	703, 718
Chicago, etc. Coal Co. v. People	580, 586, 587, 588, 643, 814, 815, 816, 826, 832, 843, 845, 850, 851	Citizens State Bank v. Hawkins	473, 502, 503, 504, 533, 547
Chicago v. Cameron	223	Citizens St. R. Co. v. Memphis	120, 130, 138
v. Evans	409, 413	City Bank v. Bruce	513
Chicago, etc. R. Co. v. Ashling	16, 20, 52, 118, 123, 170, 180	City Fire Ins. Co. v. Carrigi	433
v. Auditor General	189, 198	City of Belleville v. Indianapolis,	
v. Ayres	659	etc. R. Co.	178
v. Boyd	324	City of Danville v. Noone	597
v. Butts	171	City of Denver v. Hubbard	598
v. Chicago, etc. Coal Co.	309	City of Indianapolis v. Con-	
v. City of Ottumwa	372	sumers' Gas Trust Co.	254, 274
v. Crane	385, 413	City of Kalamazoo v. Power Co.	270
v. Denver, etc. R. Co.	361, 362, 461	City of Memphis v. Memphis	
v. Doaul	394	Water Co.	597
v. Dunbar	261	City of New York v. Sixth Ave.	
v. Ferguson	20, 160	R. Co.	169
v. Galey	152	City of Palestine v. Barnes	254
v. Groves	468, 469	City of Spokane v. Amsterdamsch	
v. Hart	399, 400	Trustees Kantoor	237, 258
v. Illinois Central R. Co.	378	Clancy v. Onondaga Fine Salt	
v. Lundstrom	242, 311	Mfg. Co.	667, 668
v. Martin	468, 469	Clapp v. Peterson	239, 513, 515
v. Mitchell	468	Clark v. Central, etc. R. Co.	77, 520
v. Moffitt	128, 151, 152, 160	v. Chicago, etc. R. Co.	470
v. Northern Pacific R. Co.	464	v. Cyclone Woven Wire	
v. Posten	468, 469	Fence Co.	823
v. Pullman Southern Car Co.	604	Clarke v. Omaha, etc. R. Co.	56, 272, 280, 290, 341
v. Schmitz	394		
v. Stafford County	136, 179		
v. State	30		

## TABLE OF CASES

	PAGE		PAGE
Clary v. Iowa Midland R. Co.	387,	Columbus R. Co. v. Indianapolis	
	415, 419	R. Co.	659
Claw v. Van Loan	281	Comer v. Burton, etc. Co.	817
Clayton v. Ore Knob Co.	572, 576	Commercial Electric Light, etc. Co.	
Clearwater v. Meredith	13, 27, 81, 82,	v. City of Tacoma	266
	90, 92, 115	Commercial Fire Ins. Co. v.	
Cleland v. Anderson	796, 800, 815,	Montgomery Co.	477, 480, 493
	821, 849	Commercial Nat. Bank v. Burch	513,
Clement v. Canfield	415		515
Clemons v. Meadows	657, 817	Commercial Union Ins. Co. v.	
Cleveland, etc. R. Co. v. Berry	468	Shoemaker	581
v. Bender	466, 468	Commissioners of Tippecanoe Co.	
v. Closser	653, 661	v. Lafayette, etc. R. Co.	22, 327,
v. Erie	54		339, 345, 346, 350, 448
v. Prewitt	160	Commonwealth v. Alger	791
Cleveland v. Spencer	372	v. Atlantic, etc. R. Co.	108, 173,
Cleveland City R. Co. v. First			179
National Bank	79, 90, 108	v. Bavarian Brewing Co.	805, 823
Clinch v. Financial Corpora-		v. Boston, etc. R. Co.	514
tion	25, 221, 233	v. Buffalo, etc. R. Co.	194
Clokey v. International, etc. Co.	242	v. Chesapeake, etc. R. Co.	358
Clyde v. Richmond, etc. R.		v. Grinstead	818, 843, 844
Co.	429	v. Hemingway	519
Coal Creek, etc. Co. v. Tennessee		v. Hunt	579
Coal, etc. Co.	313, 321	v. Judd	580
Coe v. Columbus, etc. R. Co.	254,	v. Lowell Gas Light Co.	266
	255, 267, 272, 280	v. Nashville, etc. R. Co.	305, 408
v. East & West R. Co.	571	v. New York, etc. R. Co.	520
Coffin v. Ransdell	571, 576	v. Northern El. Light, etc.	
Coggin v. Central R. Co.	159, 166	Co.	57
Cohen v. Berlin & Jones Env.		v. Owensboro, etc. R. Co.	306
Co.	559, 645, 655	v. Pennsylvania R. Co.	175, 414
Coit v. Gold Amalgamating Co.	571,	v. Perry	789
	576, 577	v. Smith	264
Cole v. Millerton Iron Co.	239, 247,	v. Standard Oil Co.	522
	251	v. Strauss	792
Coleman v. Eastern Counties R.		v. Waterman	579
Co.	444	Compton v. Wabash, etc. R. Co.	16,
v. Howe	239, 577		20, 165
Coler v. Tacoma R., etc. Co.	226, 228,	Conant v. Bellows Falls Canal	
	492, 520	Co.	356
Coleson v. Blunton	358	Concord Nat. Bank v. Hawkins	533
Colgate v. Bachelier	603	Coney Island, etc. R. Co. v.	
v. New York, etc. R. Co.	130	Brooklyn Cable Co.	456, 460
v. U.S. Leather Co.	49, 83, 85, 90,	Conn v. Chicago, etc. R. Co.	197
	92, 112, 125, 157, 184, 185, 548	Connolly v. Union Sewer Pipe	
Collins v. Chicago, etc. R. Co.	173	Co.	674, 747, 758, 798, 799
Colt v. Barnes	267	Connor v. City of Marshfield	254
Columbia, etc. Co. v. Kentucky		Conro v. Port Henry Iron Co.	314, 344
Union R. Co.	411	Consolidated Gas Co., <i>In re</i>	830, 832
Columbia Carriage Co. v. Hatch	819	Consolidated Gas Co. v. Balti-	
Columbia Wire Cloth Co. v. Free-		more County Commrs.	131
man Wire Cloth Co.	675, 823	Consolidated Traction Co. v.	
Columbus, etc. R. Co. v. Burke		Elizabeth	128
	474, 480, 493	Consolidated Water Power Co. v.	
v. Pennsylvania Co.	463, 464	Nash	212
v. Powell	152	Continental Building, etc. Ass'n	
v. Skidmore	152, 156, 166, 174	v. Miller	91

## TABLE OF CASES

	PAGE		PAGE
Continental Ins. Co. v. New York, etc. R. Co.	340, 350, 360, 446, 448	Cumberland Valley R. Co. v. Gettysburg, etc. R. Co.	659
Continental Trust Co. v. Toledo, etc. R. Co.	49, 52, 55, 176, 178, 181, 187	Cummings v. Union Blue Stone Ass'n	550, 650, 655
Continental Wall Paper Co. v. Voight	708, 724, 749	Cunkle v. Interstate R. Co.	171
Cook v. Detroit, etc. R. Co.	161	Cupit v. Park City Bank	213
v. Marshall	522	Curran v. Arkansas	168
v. Milwaukee, etc. R. Co.	415	v. Galen	587
Cooper v. Day	358	Carrier v. Concord R. Co.	69, 77
v. Shropshire Union R. Co.	132, 147	v. Lebanon State Co.	511
Copeland v. Citizens Gas Light Co.	314, 319	Currier Case	576
v. Memphis, etc. R. Co.	188	Curtis v. Cleveland, etc. R. Co.	397, 399
v. Minong Min. Co.	124		
Coppin v. Greenles, etc. Co.	257, 511, 512	D	
Coquard v. National, etc. Co.	657, 678, 681, 682	Dady v. Georgia, etc. R. Co.	69, 80, 185, 347
Cordova Coal Co. v. Long	158	Dana v. American Tobacco Co.	95
Cork, etc. R. Co., <i>In re</i>	439	v. Bank of United States	203
Cork v. Patterson	133	Daniels v. St. Louis, etc. R. Co.	142, 307
Corning, <i>In re</i>	707, 752	Darcy v. Allen	594
Cotzhausen v. H. W. Johns Mfg. Co.	160	Dartmouth College v. Woodward	81, 473
Council Grove, etc. R. Co. v. Lawrence	171	Davis, Matter of	833, 834, 844
County Court v. Baltimore, etc. R. Co.	504	Davis v. A. Booth & Co.	637, 704, 802, 813, 816
County of Gloucester Bank v. Rudry Merthyr, etc. Co.	303	v. Cong. Beth Tephilus Israel	25
County of Mobile v. Kimball	715	v. Gemmell	223
Couse v. Columbia Powder Mfg. Co.	244, 245, 249	v. Massachusetts	790
Covington, etc. Turnpike Co. v. Sanford	790	v. Memphis, etc. R. Co.	299
Coyle v. Pittsburgh, etc. R. Co.	419	v. New York	267
Coyne v. Warrior Southern R. Co.	290	v. Old Colony R. Co.	351, 433, 439, 440
Cox v. Terre Haute, etc. R. Co.	423, 441	v. Providence, etc. R. Co.	388, 416
Craft v. McConoughy	591, 599, 651, 658, 667	v. United States Electric Power, etc. Co.	476, 524, 547, 551
Crandall v. Lincoln	239, 511, 512, 515	Day v. New Orleans, etc. R. Co.	160
Crane v. Fry	543	v. New York, etc. R. Co.	146, 170
Crawford v. Longstreet	313	v. Ogdensburg, etc. R. Co.	187, 270, 338, 341, 370, 453
Crawfordsville, etc. Turnpike Co. v. Fletcher	144	v. Postal Tel. Co.	424
v. State	27	v. Spiral Springs Buggy Co.	257
Crump v. Ligon	816, 833	v. Worcester, etc. R. Co.	153, 156
Crystal Ice Co. v. Wylie	849	Dandrick v. Wilson	89, 212
Cullen v. Coal Creek, etc. R. Co.	541	Debs, <i>In re</i>	714, 739, 750
Cumberland Coal Co. v. Sherman	225	De Camp v. Aylward	213, 299
Cumberland Tel., etc. Co. v. City of Evansville	237, 253, 266, 268, 272, 273	De La Vergne Refrigerating Mach. Co. v. German Savings Inst.	473, 496, 535, 545, 546
		Delaware, etc. R. Co. v. Rutter	738
		v. Frank	748
		Delaware R. Co. v. Tharp	133
		v. Salmon	466

# TABLE OF CASES

	PAGE		PAGE
Delaware R. R. Tax	81, 141, 195, 196	Drake v. Siebold	650
De Neufville v. New York, etc. R. Co.	549	Driscoll v. Norwich, etc. R. Co.	393, 403
Denike v. New York, etc. Cement Co.	313, 316, 319	Dronfield Silkstone Coal Co. R.	511, 514
Dennehy v. McNulta	423, 673	Dryden v. Grand Trunk R. Co.	414
Denny Hotel Co. v. Schram	477, 482, 519, 546	Dubuque, etc. R. Co. v. Litchfield v. Sioux City Railroad Co.	334, 543
Denver, etc. R. Co. v. Denver City R. Co.	267, 268	Dudley v. Kentucky High School	86, 216
Deposit Bank v. Barrett	507	Dueber Watch Case Mfg. Co. v. Howard Watch, etc. Co.	705, 716, 720
Descombes v. Woods	225	Dunbar v. American Telephone Co.	478, 523, 538, 539, 540, 546, 640, 643, 812, 814
Detroit Salt Co. v. National Salt Co.	640, 656, 669, 686, 850, 851	Dupee v. Boston Water Power Co.	513
Devine v. Frankfort Steel, etc. Co.	219	Du Pont v. Tilden	576
De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.	559, 599, 632, 643, 649, 651, 655, 668	Durfee v. Old Colony R. Co.	84, 86, 347
Dewey v. Toledo, etc. R. Co.	259, 506		
Diamond Match Co. v. Roeber	605, 623, 645	E	
Dickerman v. Northern Trust Co.	575, 576	Earle v. Seattle, etc. R. Co.	81, 327, 458
Dickey v. Railway Co.	310	East Alabama R. Co. v. Doe	253
Dickinson v. Cunningham v. Consolidated Traction Co.	337, 347, 348, 350, 447	East Anglian R. Co. v. Eastern Counties R. Co.	32, 327, 435
Dickson v. Chicago, etc. R. Co.	419	East Boston, etc. R. Co. v. Eastern R. Co.	270, 303
Dietrichs v. Lincoln, etc. R. Co.	378	East India Co. v. Sandys	593
Dillaway v. Boston Gas Light Co.	529	East Lincoln v. Davenport	136
Dimpfel v. Ohio, etc. R. Co.	33, 105, 182, 296	East Line, etc. R. Co. v. Culbertson	401, 402
Distilling, etc. Co. v. People	607, 619, 639, 642, 681, 682, 687	v. Rushing	49, 73, 74, 273, 280, 281, 290, 302
Ditchett v. Spuyten Duyvil, etc. R. Co.	387, 391, 398, 415	v. State	27, 49, 52, 53, 73, 77, 272, 281, 290, 302, 335, 448, 449
Dittman v. Distilling Co.	492, 495, 496, 518, 529, 637, 679, 682	East St. Louis, etc. R. Co. v. Gerber	387
Dix v. Shaver	135	v. Jarvis	22, 64, 65, 66, 73
Dock v. Schlichter Jute Cordage Co.	513	v. Wabash, etc. R. Co.	174
Dodge v. Wolsey	215	East Tennessee, etc. R. Co. v. Hamblin Co.	305
Dolph v. Troy Laundry Mach. Co.	558, 651, 654	v. Nashville, etc. R. Co.	443
Doremus v. Hennessey	581	Eastern Building, etc. Ass'n. v. Williamson	260
Dougan's Case	17, 93	Eastern Counties R. Co. v. Hawkes	442
Douglass v. Concord, etc. R. Co.	92, 96	Eastern Plank R. Co. v. Vaughan	482
Dow v. Biedleman v. Northern R. Co.	307, 327	Eastern Townships Bank v. St. Johnsbury, etc. R. Co.	369
Downing v. Chicago, etc. R. Co.	387, 415	Eastern Union R. Co. v. Cochrane	131
v. Mt. Washington R. Co.	257	Easton v. Houston, etc. R. Co.	430
v. Lewis	835	Easun v. Buckeye Brewing Co.	227, 231, 473, 507, 508
Doyle v. Leitelt	211	Eaton, etc. R. Co. v. Hunt	116, 118, 156, 162, 199
Drake v. New York Sub. Water Co.	89		

# TABLE OF CASES

	PAGE		PAGE
Eclipse Tow Boat Co. v. Ponchar-		Export Lumber Co. v. South	
train R. Co.	558, 659	Brooklyn Sawmill Co.	820
Edison Electric Light Co. v. New			
Haven El. Co.	119		
v. Sawyer-Man Electric Co.	595,	F	
	675		
v. U. S. El. Lighting Co.	170	Factors, etc. Ins. Co. v. New Har-	
v. Westinghouse	170	bor Protection Co.	27, 476, 477,
Edwards v. Bringier Sugar Ext.			519
Co.	572	Fairbanks v. Leary	591, 658
v. People	136	Fame Hose Co., Appeal of	20
Edwards County v. Jennings	596	Fanning v. Osborne	281
Eel River Co. v. State	449	Farmers, etc. Bank v. Champlain	
Egerton v. Brownlow	610	Traction Co.	513
Eisel v. Hayes	604	Farmers Loan, etc. Co. v. Chicago,	
Elbogen v. Gerbereaux-Flynn Co.	219	etc. R. Co.	430
Eldred v. American Palace Car		v. New York, etc. R. Co.	547,
Co.	216, 218		548, 549
Elkins v. Camden, etc. R. Co.	216,	v. Northern Pacific R. Co.	425,
459, 474, 506, 538, 539, 545			427, 429
Ellerman v. Chicago Junction R.,		v. St. Joseph, etc. R. Co.	345
etc. Co.	538	v. Toledo, etc. R. Co.	178, 180,
Ellis v. Inman	708, 724, 755, 757		181, 230, 297
Elmira Rolling Mill Co. v. Erie		Farnum v. Blackstone Canal Co.	192
R. Co.	462	Farnsworth v. Western Union	
Elysville Mfg. Co. v. Oskisko Co.	476	Tel. Co.	325
Elyton Land Co. v. Dowdell	206, 227	Farrar v. South Western R. Co.	428
Emery v. Ohio Candle Co.	650, 655,	Farwell v. Great West. Tel. Co.	571
	668	v. Houghton Copper Work	514
Empire Assurance Corporation,		Fayette Land Co. v. Louisville,	
<i>In re</i>	18	etc. R. Co.	258
Empire Distilling Co. v. McNulta	423,	Featherstonhaugh v. Lee Moor	
	425, 426	Porcelain Clay Co.	313, 317
Empire Mills v. Alston Grocery		Fee v. New Orleans Gas Light	
Co.	523	Co.	107, 116, 120, 124
Empire Township v. Darlington	136	Feital v. Middlesex R. Co.	417
Enfield Toll Bridge Co. v. Hart-		Feld v. Roanoke Investment Co.	212,
ford, etc. R. Co.	270		224, 229
Era Ins. Soc., <i>Re</i>	25	Felton, Receiver v. City of Cin-	
Erie, etc. R. Co. v. Pennsylvania		cinnati	406
R. Co.	371	Female Orphan Asylum, <i>Re</i>	313
Ertz v. Produce Exch. Co.	588, 822	Ferd Heim Brewing Co. v.	
Ervin v. Oregon, R. etc. Co.	180, 205,	Belinder	586, 605, 814, 819, 838
208, 217, 218, 222, 223, 548		Fernschild v. Yuengling Brew-	
Espenson v. Kolpe	816	ing Co.	242, 243
Evans v. Bailey	510	Fidelity Insurance, etc. Co. v.	
v. Boston Heating Co.	266	Shenandoah Valley R. Co.	358
v. Interstate Rapid Transit		Fidelity Insurance Co. v. German	
Co.	170	Sav. Bank	502, 534
v. Sabine, etc. R. Co.	403	Field v. Barber Asphalt Co.	597, 716,
v. Smallcomb	225		719
v. Union Pacific R. Co.	222	Fietsam v. Hay	261, 262, 263
Evansville, etc. R. Co. v. Com-		Financial Corporation, <i>In re</i>	475
monwealth	305, 306	Finch v. Schneider Granite Co.	656,
Ewing v. Composite Brake Shoe			803, 822, 834
Co.	248	Finnegan v. Norrenberg	176
.. Exchange Bank v. Macon, etc. R.		First National Bank v. Chatta-	
Co.	516	nooga, etc. Co.	248



# TABLE OF CASES

	PAGE		PAGE
First National Bank v. Dovetail Body, etc. R.	241	Freeman v. Sea View Hotel Co.	202
v. Hawkins	533	Freemont Carriage Mfg. Co. v. Thomsen	513
v. Louisville, etc. R. Co.	375	Frenkel v. Hudson	571
v. Nat. Exch. Bank	473	Friedenwald Co. v. Asheville Tobacco Works	242
v. North Alabama, etc. Co.	238	Frisbie v. United States	790
v. Salem Capital Flour Mills Co.	513	Froelich v. Musicians' Mut. Ben. Ass'n	588
Fischer v. West Virginia R. Co.	328, 392	Frothingham v. Barney	230
Fishburn v. City of Chicago	597	Fry v. Lexington, etc. R. Co.	83, 133
Fisher v. Evansville, etc. R. Co.	31, 80, 81, 89	Fuqua v. Pabst Brewing Co.	810
v. Metropolitan El. R. Co.	398		
v. New York Central, etc. R. Co.	147, 338, 409, 411	G	
Fitzgerald v. Missouri Pacific R. Co.	189, 190, 191, 193, 197, 543	Gage v. State	804
Fitzmaurice v. Bailey	366	Gaither v. Stockbridge	422, 423
Flagg v. Manhattan R. Co.	382	Gale v. Troy, etc. R. Co.	169
Flynn v. Brooklyn City R. Co.	447, 448	Galpin v. Abbott	358
Fogg v. Blair	238, 252	Galveston, etc. R. Co. v. Cowdrey	330
Fontaine v. Southern Pacific R. Co.	387	v. Daniels	400, 402
Foote v. Emerson	669	v. Gartesier	392
Ford v. Chicago Milk Shippers Ass'n	588, 651, 811, 834, 838	v. Texas	44
Foreman v. Bigelow	571	Gamble v. Queens County Water Co.	548, 572
Forrest v. Manchester, etc. R. Co.	322	Gamewell Fire Alarm Tel. Co. v. Crane	604
Forrester v. Boston, etc. Min Co.	205, 209, 210, 216, 223, 228, 229	Gardner v. Hamilton Mut. Ins. Co.	124
Fort Payne Bank v. Alabama Sanitarium	204, 244, 245, 250	v. London, etc. R. Co.	458
Fort Wayne, etc. R. Co. v. Heinebaugh	388	v. Minneapolis, etc. R. Co.	125
Fort Worth, etc. R. Co. v. State	829, 845	Garst v. Harris	744
Fort Worth Pub. Co. v. Hitson	225	Gasquet v. Fidelity Trust, etc. Co.	528
Foss v. Cummings	667, 668	Gates v. Hooper	806, 816
Foster v. Fowler	253	v. Tippecanoe Stone Co.	576
Fougeray v. Cord	217	Geer v. Amalgamated Copper Co.	539
Fowle v. Parke	604, 744	General Electric Co. v. Wise	747
Fox, etc. Steel Co. v. Schoen	602, 657	George v. Central R., etc. Co.	359, 547, 550
Frank v. New York, etc. R. Co.	367, 368, 423, 428	Georgia, etc. Banking Co. v. Smith	785
Franklin Bank v. Commercial Bank	474, 481, 504, 530	Georgia, etc. R. Co. v. Friddle	471
Franklin Co. v. Lewiston Savings Inst.	473, 480, 499	v. Wilks	147
Franklin Life Ins. Co. v. Adams	159	Georgia Pacific R. Co. v. Gainet	74, 147
v. Hickson	157, 170	Georgia R. Co. v. Maddox	337, 343, 456
Frazier v. Railway Company	273, 280	Georgia R., etc. Co. v. Atlantic Postal Tel. Coal Co.	666
Freeman v. Minneapolis, etc. R. Co.	327, 392, 454	v. Haas	273, 294, 396
		Gere v. New York Central R. Co.	22, 67, 327, 338, 365
		German American, etc. Ass'n v. Droge	509
		Germer v. Triple-State Natural Gas, etc. Co.	230, 496
		Getz Bros. & Co. v. Federal Salt Co.	668, 708, 749, 819, 837

# TABLE OF CASES

	PAGE		PAGE
Gibbons v. Ogden	75, 76, 715	Green v. Coast Line R. Co.	394
Gibbs v. Consolidated Gas Co.	47, 88, 653, 665	v. Stoller	727
v. McNeeley	717, 720, 724, 729, 755	Green Bay, etc. R. Co. v. Union Steamboat Co.	459
Gilbert v. Washington City, etc. R. Co.	431	Green County v. Conness	19, 122, 123, 128
Gilkie, etc. Co. v. Dawson, etc. Co.	576	Greene, <i>In re</i>	694, 705, 707, 711, 716, 720, 746, 751, 752, 753
Gilliland v. Chicago, etc. R. Co.	313	Greenville Compress, etc. Co. v. Planters, etc. Compress Co.	25, 183, 257
Giozza v. Tiernan	790	Greenwood v. Freight Co.	522
Gladish v. Bridgeford	822	Greer v. Payne	667, 668, 669
v. Kansas City Live Stock Exch.	588, 658	v. Stoller	749
Glengarry Consol. Min. Co. v. Boehmer	219, 318, 448, 547	Gregory v. Patchett	224, 548
Globe Tobacco Warehouse Co. v. Leach	676	Grenell v. Detroit Gas Co.	245, 249
Gloninger v. Pittsburgh, etc. R. Co.	270, 303, 365	Grice, <i>In re</i>	754, 789, 796, 827
Gloucester Ferry Co. v. Pennsylvania	715	Griffin v. Piper	651, 658
Gloucester Isinglass, etc. Co. v. Russia Cement Co.	651, 654	Gross v. U. S. Mortgage Co.	330
Glymont Imp., etc. Co. v. Toller	88, 224, 229	Guaranty Trust Co. v. Atlantic Coast Electric Co.	528
Goetz v. Knie	213	Gubernator v. City of New Orleans	314
Goodin v. Cincinnati, etc. Canal Co.	547	Gue v. Tide Water Canal Co.	253, 255
v. Evans	572	Gulf, etc. R. Co. v. Galveston, etc. R. Co.	463
Goodwin v. Bodcaw Lumber Co.	217, 237	v. Hewes	305
Goodyear Shoe Mach. Co. v. Daucel	242	v. Miami Steamship Co.	660, 661, 738, 750
Gottschalk v. Lincoln, etc. R. Co.	378	v. Morris	253, 273, 275, 280, 328
Gould v. Head	566, 569	v. Newell	19, 27, 82, 161, 300
v. Langdon	155	v. State	64, 69, 74, 77
Graham v. Boston, etc. R. Co.	193, 330, 357	Gunn v. Central R., etc. Co.	566
v. Chicago, etc. R. Co.	308	Gyger v. Philadelphia, etc. R. Co.	72
v. Macon, etc. R. Co.	203		
Grand Trunk R. Co. v. Central Vermont R. Co.	370, 430		
Grand Trunk West. R. Co. v. Chicago, etc. R. Co.	364, 465		
Gray v. De Castro, etc. Sugar Ref. Co.	614		
v. Massachusetts Cent. R. Co.	363		
v. National Steamship Co.	238		
v. Oxnard Bros.	667, 668, 671		
Great Eastern R. Co. v. Turner	476		
Great Northern R. Co. v. Eastern Counties R. Co.	274, 328, 476		
v. Manchester, etc. R. Co.	459		
Great Western R. Co. v. Bristol Port R. Co.	462		
v. Metropolitan R. Co.	476		

## H

Hadley Dean Plate Glass Co. v. Highland Glass Co.	747, 810
Hafer v. Cincinnati, etc. R. Co.	55, 77
Haff v. Minneapolis, etc. R. Co.	418
Hagan v. Blindell	750
Hagemann v. Southern Electrical Co.	238, 249, 309
Hale v. Cheshire R. Co.	84, 86
v. Henkel	761
Hall v. Brown	418
v. Herter	243
v. Sullivan R. Co.	265, 270, 330
v. Tanner, etc. Engine Co.	203
v. White	670
Hamilton v. Clarion, etc. R. Co.	133, 180
v. Menominee Falls Quarry Co.	251
v. Mut. Ins. Co. v. Hobart	83
v. Savannah, etc. R. Co.	69, 77, 327, 473

# TABLE OF CASES

	PAGE		PAGE
Hamlin v. Jerrard	162, 163	Havemeyer v. Superior Court	683
Hammond Packing Co. v. State	805,	Hawarden v. Youghiogheny, etc.	
	845, 851	Coal Co.	583, 586
Hammond v. Port Royal, etc. R.		Hawes v. Oakland	216
Co.	309	Hawkins v. Central of Georgia R.	
Hamor v. Taylor Rice Engineer-		Co.	152, 309
ing Co.	511	v. Small	143
Hampe v. Mt. Oliver I. R. Co.	53	Hawley v. Gray Bros., etc. Co.	359
v. Traction Co.	342	Hayden v. Atlanta Cotton Fac-	
Hamsher v. Hamsher	258	tory	571
Hancock v. Holbrook	211, 214, 225	v. Official Red Book and Di-	
v. Louisville, etc. R. Co.	53, 524	rectory Co.	206, 208, 211, 217
Hand v. Savannah, etc. R. Co.	305	Hayes v. Northern Pacific R. Co.	387,
Hanna v. Cincinnati, etc. R. Co.	80,		390, 392, 396, 402
	94, 135, 170	v. Ottawa, etc. R. Co.	301, 444
v. Railway Co.	396, 402	Hays v. Illinois, etc. Co.	273
Hannibal, etc. R. Co. v. Marion		Hazard v. Vermont, etc. R. Co.	324,
County	136		341, 383
Hanson v. Power	669	Hazlehurst v. Savannah, etc. R.	
Harbison v. Knoxville Iron Co.	792	Co.	473, 479, 538
Harden v. North Carolina R. Co.	395,	Hearst v. Putnam Min. Co.	203, 222
	401	Heath v. Missouri, etc. R. Co.	300
Harding v. American Glucose Co.	229,	Heck v. McEwen	482
608, 611, 625, 641, 644, 651, 677,		Heims Brewing Co. v. Flannery	437
678, 679, 680, 686, 826		Heimbsbueher v. Goff	656, 708, 818
Hare v. London, etc. R. Co.	59, 450,	Hendee v. Pinkerton	256, 365
	558, 661, 663	Hendrie v. Grand Trunk R. Co.	355
Harkness v. Manhattan El. R. Co.	383	Henry v. Pittsburgh, etc. R. Co.	346
Harmon v. Columbia, etc. R. Co.	328,	Henry County v. Nicolay	136
	393, 395, 404	Heron v. St. Paul, etc. R. Co.	397,
Harper v. Newport News, etc. R.			466
Co.	395	Herriman v. Menzies	559, 598, 643,
Harriman v. Northern Securities			650, 686
Co.	518, 732	Herring v. Ruskin	511
Harrison v. Arkansas Valley R.		Hervey v. Illinois Midland R. Co.	54,
Co.	152, 168		296
v. Glucose Sugar Refin. Co.	604,	Hess Mfg. Co., <i>In re</i>	576
	673, 747, 838	Hibernia Ins. Co. v. St. Louis,	
v. Union Pac. R. Co.	152	etc. Transportation Co.	244, 248
Harshman v. Bates County	137	Higgins v. Downward	299
Hart v. Railroad Co.	396	Hiles v. Hiles Co.	19
Harter v. Kernochan	136	Hill v. Atlantic, etc. R. Co.	337, 351,
Hartford, etc. R. Co. v. New			352, 356, 364, 383
York, etc. R. Co.	659	v. Beach	522
Hartford Fire Ins. Co. v. Chicago,		v. Fogg	226
etc. R. Co.	321, 375	v. Gould	219, 220
v. Raymond	825, 846	v. Gruell	249
Hartman v. John D. Park & Sons		v. Nisbet	90, 221, 499, 505
Co.	744	v. Rich Hill Coal Min. Co.	535
Hartwell v. Buffalo, etc. R. Co.	498	Hinds County v. Natchez, etc. R.	
Hartz v. Eddy	686, 851	Co.	294
Hastings Industrial Co. v. Baxter	836	Hitchcock v. Barrett	446
Hastings Malting Co. v. Iron		v. Galveston	441
Range Brewing Co.	572, 576, 577	Hoag v. Hannibal, etc. R. Co.	257
Hatch v. American Union Tel.		Hoard v. Chesapeake, etc. R. Co.	161
Co.	236	Hodder v. Kentucky, etc. R. Co.	357
Hatcher v. Toledo, etc. R. Co.	32, 161,	Hodges v. New England Screw	
	330	Co.	216, 231, 500, 501, 502, 508

## TABLE OF CASES

	PAGE		PAGE
Hoene v. Pollak	224	Hunter v. Columbia, etc. R. Co.	388
Hoffman v. Brooks	646, 648, 651	Hunting v. Hartford St. R. Co.	335,
Hollifield v. Wrightsville, etc. R. Co.	540		342
Hollins v. Brierfield Coal, etc. Co.	241	Hurd v. New York, etc. Laundry Co.	239, 248
v. St. Paul, etc. R. Co.	223	Hurd County v. Natchez, etc. R. Co.	517
Holman v. Johnson	435	Hutchins v. Hutchins	581
Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co. 204, 258, 502, 508,	537	v. Weldon	670
Holst v. Sidney, etc. Coal, etc. Co.	235	I	
Home Friendly Soc. v. Tyler	25	Illinois Cent. R. Co. v. Kanouse	415
Hood v. New York, etc. R. Co.	499	v. Lucas	395
Hoole v. Great Western R. Co.	222	Illinois, etc. R. Co. v. Cook	81
Hooper v. California	715, 790	Illinois State Trust Co. v. St. Louis, etc. R. Co.	291
Hope v. International Financial Soc.	511	Imperial Mercantile Credit Ass'n, <i>In re</i>	233
Hopkins v. St. Paul, etc. R. Co.	161	Independent Refiners' Ass'n v. Western New York, etc. R. Co.	664
v. United States	715, 716, 717, 718, 727, 728	India Bagging Ass'n v. Koch	607,
Horne v. Boston, etc. R. Co.	190, 191, 193, 198		650, 658, 667
v. Railroad Co.	193	India Mut. Ins. Co. v. Worcester, etc. R. Co.	156
Horner v. Graves	605	Indiana Mfg. Co. v. J. I. Case Threshing Co.	740, 741, 742
Hospe v. Northwestern Mfg., etc. Co.	241	Indianapolis, etc. R. Co. v. Jones	152,
Houck v. Anheuser Busch Brew- ing Ass'n	796		153, 160, 166, 173
v. Wright	818	v. Solomon	466
Hough v. Cook County Land Co.	258	v. State	253
Houston, etc. R. Co. v. Shirley	19, 21, 161, 166, 167	Indianapolis Mfg. Union v. Cleve- land, etc. R. Co.	367, 374
v. McFadden	325, 398	Indianola R. Co. v. Fryer	116, 166, 171
Howard v. Chesapeake, etc. Co.	392, 452	Ingersoll v. Stockbridge, etc. R. Co.	388
Howe v. Boston Carpet Co.	502, 503, 508	Ingraham v. Nat. Salt Co.	551
Howe Grain, etc. Co. v. Jones	513	Inhabitants of Waldoborough v. Knox, etc. R. Co.	348
Howell v. Lansing, etc. Traction Co.	20, 181	Interborough-Metropolitan Co., <i>In re</i>	832
Hubbard v. Chappell	173	International, etc. R. Co. v. Bremond	89, 91, 95
v. Miller	604	v. Eckford	392
Huck v. Chicago, etc. R. Co.	408	v. Moody	328
Huggins v. Milwaukee Brewing Co.	238	v. Thornton	404
Hukill v. Maysville, etc. R. Co.	392, 393, 402	International Harvester Co. v. Commonwealth	818, 828
Hukle v. Atchison, etc. R. Co.	309	v. Kentucky	844
Humphreys v. Mooney	520	Interstate Commerce Com. v. Texas, etc. R. Co.	188
v. McKissock	354, 543	Iowa Lumber Co. v. Foster	513, 514
v. Pegues	306	Irrigation Co., <i>In re</i>	233
v. St. Louis, etc. R. Co.	355, 359, 434	Irvin v. New Orleans, etc. R. Co.	407,
Hunt v. American Grocery Co.	211, 214		407,
v. Hauser Malting Co.	473, 480, 501, 534		
v. Riverside Coöperative Club	815, 821		

# TABLE OF CASES

	PAGE		PAGE
Island City Savings Bank v. Sachtleben	226	Judd v. Harrington	641, 645, 651, 658,
v. Schattchen	238		667
Isom v. Rex Crude Oil Co.	119, 122	Justices, <i>In re</i> Opinion of	793
Ives v. Smith	664		
		K	
J		Kadish v. Garden City, etc. Ass'n	508
Jack v. Kansas	793, 805	Kann v. Illinois Southern R. Co.	309
Jackson v. Brick Ass'n	650, 655	Kansas City Hotel Co. v. Sauer	226
v. Ludeling	180, 548	Kansas, etc. R. Co. v. Smith	171
Jacksonville, etc. R. Co. v. Hooper	313, 357, 358, 376	Kassler v. Kyle	514
v. Louisville, etc. R. Co.	364	Kaufman v. Pittsburgh, etc. R. Co.	335, 336, 342
Jayne v. Loder	744	Kavanaugh v. Omaha Life Ass'n	25,
Jefferson v. Chicago, etc. R. Co.	467		50, 176
Jeffersonville, etc. R. Co. v. Hendricks	160	Kean v. Johnson	82, 208
Jemison v. Citizens Savings Bank	434	Kearney v. New Jersey Central R. Co.	419
		v. Central R. Co.	390
Jersey City Gas Co. v. Dwight	266	Keeley Brewing Co. v. Mason	313
Jersey City Gas Light Co. v. United Gas Imp. Co.	322, 323, 371	Keller v. Kansas City, etc. R. Co.	388
Jessup v. Illinois Cent. R. Co.	22, 225, 446, 542, 547	Kellogg v. Larkin	611, 646, 658
John D. Park & Sons Co. v. Nat. Wholesale Druggists Ass'n	607, 704	v. Lehigh Valley R. Co.	587
John Hancock, etc. Ins. Co. v. Worcester, etc. R. Co.	127, 156	Kelly v. Fletcher	576
Johnson v. Shrewsbury, etc. R. Co.	458	Kennebec, etc. R. Co. v. Portland, etc. R. Co.	330
v. State	143, 269	Kennedy v. California Savings Bank	504, 533
Johnson Co. v. Miller	256	Kenosha, etc. R. Co. v. Marsh	85, 133
Johnson County v. Thayer	513	Kent v. City of Binghamton	130, 308
Johnson Pub. Co. v. Mills	832	v. Quicksilver Mining Co.	214, 223
Johnston v. Markle Paper Co.	572	Kent Coast, etc. R. Co. v. London, etc. R. Co.	356
Joint Stock Discount Co. v. Brown	480	Kentucky, etc. Bridge Co. v. Louisville, etc. R. Co.	660
Jones v. Arkansas Mechanical and Agricultural Co.	245	Keokuk, etc. R. Co. v. Missouri	12,
v. Brim	790		114, 116, 121, 128, 139, 306
v. Carter,	600, 806, 811, 814	v. Scotland County	138, 139
v. Concord R. Co.	341, 342, 346	Kern v. Day	535
v. Georgia Southern R. Co.	403	Kersey Oil Co. v. Oil Creek, etc. R. Co.	346, 352
v. Guaranty, etc. Co.	203	Ketcham v. Madison, etc. R. Co.	177
v. Lees	605	Kevil v. Standard Oil Co.	816
v. Missouri-Edison Electric Co.	25, 57, 90, 179, 184	Key City, The	162
v. Seaboard Air Line R. Co.	160	Kidd v. Pearson	719
v. Southern R. Co.	169	Killian v. Augusta, etc. R. Co.	470
v. Whitworth	576	Kimball v. Atchison, etc. R. Co.	72,
Jones' Case	578		77, 496
Jordan v. Collins	204	v. Harman	581
Joseph v. Raff	513	Kinion v. Kansas City, etc. R. Co.	116, 170, 171, 172
v. Southern R. Co.	161	Kinner v. Lake Shore, etc. R. Co.	673
Joy v. City of St. Louis	465	Kinney v. North Carolina R. Co.	395
v. Jackson, etc. Plank Road Co.	203	Kip v. New York, etc. R. Co.	378
		Klingel's Pharmacy v. Sharp	578,
			586, 588, 607, 643
		Klosterman v. Maçon County, etc. R. Co.	270

# TABLE OF CASES

	PAGE		PAGE
Knickerbocker v. Conger	235	Leather Cloth Co. v. Lorsont	605
Knoup v. Piqua Branch of State Bank	263	Leathers v. Janney	204, 220
Knowles v. Sandercock	473, 477, 498	Leavenworth v. Chicago, etc. R. Co.	178
Knoxville v. Knoxville, etc. R. Co.	48, 81, 86, 251, 294	Leavenworth County v. Barnes	182
Knoxville Iron Co. v. Harbison	790, 792	v. Chicago, etc. R. Co.	110
Koehler v. Feurbach	610	Lebeck v. Fort Payne Bank	252
Kohl v. Lilienthal	204, 234	Lee v. Atlantic Coast Line R. Co.	14, 123, 198
Koons v. Chicago, etc. R. Co.	173	v. Southern Pacific R. Co.	389, 390, 402
Kosciusko Oil Mill, etc. Co. v. Wilson Cotton Oil Co.	817	Leedam v. Plymouth R. Co.	254, 255
Kroenert v. Johnson	572, 576	Leep v. St. Louis, etc. R. Co.	788, 789, 790
Kyle v. Wagner	213	Leeper v. State	593, 832
L		Lehigh, etc. Mining Co. v. Kelly	238
Lafayette Bridge Co. v. City of Streator	673, 839	Leonard v. Abner-Drury Brewing Co.	589, 590, 681, 754
Lafayette Co. v. Neeley	222	v. New York Central, etc. R. Co.	468, 469
Lagrone v. Zimmerman	477	v. Poole	667, 668
Lake Shore, etc. R. Co. v. Ohio v. People	791, 196	Leslie v. Lorillard	605, 677, 686
Lakin v. Railroad Co.	393	Lester v. Bemis Lumber Co.	473, 531
Lancashire, etc. R. Co. v. East Lancashire, etc. R. Co.	464	Levering v. Bimel	241
Lancaster v. Amsterdam Impt. Co.	258	Levin v. Chicago Gas Light Co.	677
Langan v. Franklyn	107, 112	Levins v. People's Grocery Co.	247
Langdon v. Branch v. Vermont, etc. R. Co.	69, 77, 498, 383	Lewis v. Clarendon	128, 136, 182
Lange v. Werk	605	v. Weatherford, etc. R. Co.	818
Langhorne v. Richmond, etc. R. Co.	151, 160, 166, 173	Lewiston, etc. R. Co. v. Grand Trunk R. Co.	364, 371
Langley v. Boston, etc. R. Co.	405	Lewright v. Bell	851
Lanier Lumber Co. v. Rees	477, 478, 532	Liddle v. Keokuk, etc. R. Co.	416
Lanyon v. Garden City Sand Co.	708, 819	Liebke v. Knapp	573
Laredo v. International Bridge, etc. Co.	600	Lightner v. Boston, etc. R. Co.	120, 131
Larocque v. Beauchemin	572	Lincoln St. R. Co. v. City of Lincoln	162, 267, 268
Lasher v. People	268	Linfield v. Old Colony R. Corp.	417
Latham v. Boston, etc. R. Co.	177	Lipfield v. Charlotte, etc. R. Co.	338
Lathrop v. Commercial Bank v. Middleton	202, 255	Little Rock, etc. R. Co. v. Daniels	389, 397
Latimer v. Citizens State Bank	496, 505	v. McGehee	304
v. Richmond, etc. R. Co.	352	v. St. Louis, etc. R. Co.	659, 660, 661
Lauman v. Lebanon Valley R. Co.	27, 82, 97, 116, 208, 216, 233	Liverpool, etc. Ins. Co. v. Clunie	673
Lawrence v. Kidder	605	Live Stock Ass'n v. Levy	559
v. Morgan's Steamship Co.	266, 304	Livingston County v. Portsmouth First Nat. Bank	56, 136
v. Saratoga Lake R. Co.	465	Llanely, etc. R. Co. v. London, etc. R. Co.	461
Lawry v. Williams	358	Lloyd v. Preston	577
Lawson v. Illinois Southern R. Co.	309	Locker v. American Tobacco Co.	656, 819
Layng v. French Spring Co.	496	Lockhart v. Little Rock, etc. R. Co.	470
		Loewe v. Lawlor	725, 726, 729, 755
		Logan v. Courtown	479
		v. North Carolina R. Co.	395, 400, 419

# TABLE OF CASES

	PAGE	M	PAGE
Logan County Bank <i>v.</i> Townsend	504	MacGinnis <i>v.</i> Boston, etc. Mining	
London, etc. Bank, <i>Re</i>	511, 514	Co.	474, 475, 476, 524, 550, 641,
London, etc. Bread Co., <i>In re</i>	233		679, 680, 682, 808, 812, 813
London, etc. R. Co. <i>v.</i> Good-		Mack <i>v.</i> De Bardeleben, etc. Co.	550
win	131	Mackintosh <i>v.</i> Flint, etc. R. Co.	19,
<i>v.</i> London, etc. R. Co.	459		215, 280, 291, 473, 508
<i>v.</i> Southeastern R. Co.	410	Macon, etc. R. Co. <i>v.</i> Mayes	400, 402
Long Acre Electric Light, etc. Co.		Madison, etc. Plank Road Co. <i>v.</i>	
In Matter of,	270, 274, 276	Watertown, etc. Plank Road	
Long <i>v.</i> Georgia Pacific R. Co.	257,	Co.	444
	258	Mahaska County R. Co. <i>v.</i> Des	
Lord <i>v.</i> Copper Mines Co.	125	Moines Valley R. Co.	212, 290
Loud <i>v.</i> Pomona, etc. Co.	571	Mahoney <i>v.</i> Atlantic, etc. R. Co.	389,
Lough <i>v.</i> Outenbridge	599		397, 418
Loughlin <i>v.</i> United States School		<i>v.</i> Spring Valley Water Co.	304
Furniture Co.	187	Mallett <i>v.</i> Simpson	202, 258
Louisiana <i>v.</i> Wood	440, 441	Mallory <i>v.</i> Hanaur Oil Works	437,
Louisville, etc. R. Co. <i>v.</i> Biddell	310,		565, 566, 671
	311	Manchester, etc. R. Co. <i>v.</i> Con-	
<i>v.</i> Blythe	128	cord R. Co.	64, 69, 437, 441, 644, 661
<i>v.</i> Boney	128, 152, 166, 253,	Manchester St. R. Co. <i>v.</i> Williams	535
	255	Manny <i>v.</i> National Surety Co.	152,
<i>v.</i> Breeden's Admx.	392, 466, 469		158
<i>v.</i> Carson	318	Mansfield, etc. R. Co. <i>v.</i> Brown	79,
<i>v.</i> Chesapeake, etc. R. Co.	464		82, 106, 108, 133, 134, 179
<i>v.</i> Commonwealth	451	<i>v.</i> Drinker	108, 109, 134, 179
<i>v.</i> Cumberland, etc. R. Co.	363	<i>v.</i> Pettis	134
<i>v.</i> Gaines	306	<i>v.</i> Stout	134, 135, 179
<i>v.</i> Howard	81	Manufacturers Sav. Bank <i>v.</i> Big	
<i>v.</i> Illinois, etc. R. Co.	325	Muddy Iron Co.	212, 220
<i>v.</i> Jarvis	294	Marble Co. <i>v.</i> Harvey	474, 478, 480,
<i>v.</i> Kentucky	30, 48, 50, 75, 77,		523, 536, 538
	275, 329, 451, 473, 538	Marbury <i>v.</i> Kentucky Union	
<i>v.</i> Kentucky, etc. R. Co.	45, 46,	Land Co.	22, 499, 505
	47, 60, 65, 69, 72,	March <i>v.</i> Eastern R. Co.	221, 341
	460, 545	Marine Bank <i>v.</i> Ogden	566
<i>v.</i> Literary Society of St.		Market St. R. Co. <i>v.</i> Hellman	28, 84,
Rose	499		86, 105, 106, 111, 118, 121, 123, 482,
<i>v.</i> Louisville S. R. Co.	463		495, 524, 547
<i>v.</i> Louisville Trust Co.	331	Markey <i>v.</i> Louisiana, etc. R. Co.	388
<i>v.</i> Mississippi, etc. R. Co.	464	Marquette, etc. R. Co. <i>v.</i> Langton	173
<i>v.</i> Palmes	305	Marshall <i>v.</i> Western North Caro-	
<i>v.</i> Schmidt	374	lina R. Co.	248
<i>v.</i> Summers	160, 172	Marshall Foundry Co. <i>v.</i> Killain	239
<i>v.</i> Utz	172	Martin <i>v.</i> Continental Passenger	
Louisville Gas Co. <i>v.</i> Kaufman	543	R. Co.	295, 296, 346
Louisville Trust Co. <i>v.</i> Louisville,		<i>v.</i> Ohio Stove Co.	473, 477, 478,
etc. R. Co.	32, 181, 182, 505		492, 545
Louisville Water Co. <i>v.</i> Hamilton	253,	<i>v.</i> Wilson	535
	255	<i>v.</i> Zellerbach	234
Lowe <i>v.</i> Pioneer Threshing Co.	513	Marvin <i>v.</i> Anderson	513, 515
Lowenstein <i>v.</i> Evans	745	Maryland Trust Co. <i>v.</i> National	
Lowry <i>v.</i> Tile, etc. Ass'n	729, 755,	Mechanics Bank	511, 512
	756, 758	Mason <i>v.</i> Adoue	849
Lufkin Rule Co. <i>v.</i> Fringeli	653	<i>v.</i> Finch	87
Lyons-Thomas Hardware Co. <i>v.</i>		<i>v.</i> Pewabic Mining Co.	215, 227,
Perry Stove Mfg. Co.	239, 240		232, 233
Lytle <i>v.</i> Galveston	830		

# TABLE OF CASES

	PAGE		PAGE
Matthews v. Murchison	524, 547	McMinnville, etc. R. Co. v. Hug-	431
Maunsell v. Midland Great West-		gins	431
ern R. Co.	476	McVicker v. American Opera Co.	250
Mayfield v. Alton Ry. Gas & Elec.		v. Ross	97, 233
Co.	79, 91	McWilliams v. City of New	
Mayor, etc. of Colchester v. Law-		York	248
ton	203	Mead v. New York, etc. R. Co.	32,
Mayor, etc. of New York v.		143, 195, 199	
Miln	792	Mechanics Sav. Bank v. Meriden	
Mayor, etc. of Worcester v. Nor-		Agency Co.	477, 509
wich, etc. R. Co.	304, 378, 386	Medical College Case	482
Mayor, etc. v. Twenty-Third St.		Meeker v. Winthrop Iron Co.	180, 318,
R. Co.	413, 414	319, 446, 448, 548	
McAlister v. Florence, etc. R. Co.	477,	Mellen v. Moline Iron Works	421
478, 493		Memphis, etc. R. Co. v. Com-	
v. Henkel	763	missioners	264, 265, 305
McAlpine v. Union Pac. R. Co.	128	v. Grayson	327, 351
McBlair v. Gibbes	674	v. Wood	539, 550
McCabe Admx. v. Maysville, etc.		Memphis Barrel, etc. Co. v.	
R. Co.	327, 337, 394	Ward	239
McCall v. Chamberlain	415	Menasha v. Hazard	136
McCampbell v. Fountain Head R.		v. Milwaukee, etc. R. Co.	161
Co.	477, 478, 541	Menier v. Hooper's Telegraph	
McCandless v. Richmond, etc. R.		Works	217, 548
Co.	411, 455	Mercantile, etc. Co. v. Southern,	
McCauley v. Columbus, etc. R.		etc. R. Co.	428, 430
Co.	32	Mercantile Trust Co. v. Atlantic	
McCluer v. Manchester, etc. R.		etc. R. Co.	430
Co.	418	v. Baltimore, etc. R. Co.	430
McClure v. People's Freight R.		v. Farmers Loan, etc. Co.	425,
Co.	106	426, 427	
McConnell v. Camors-McConnell		v. Missouri, etc. R. Co.	431
Co.	705, 748	Merchants, etc. Line v. Waganer	208
McCoy v. Kansas City, etc. R. Co.	388	Meredith v. Zinc and Iron Co.	644,
v. World Columbian Expos.	535	651, 655	
McCray v. Junction R. Co.	81, 92	Merrill v. Railroad Co.	470
McCurdy v. Meyers	208	Merz Capsule Co. v. U. S. Cap-	
McCutcheon v. Merz Capsule Co.	229,	sule Co.	491, 519, 671, 798
473, 480, 491, 501, 508, 538		Metcalf v. American School	
McDonald v. Williams	241	Furniture Co.	209, 214, 221, 230,
McGeorge v. Big Stone Gap		237, 497, 637, 675, 750	
Imp't Co.	224	Methodist, etc. Church v. Pickett	176
McGrath v. New York Central,		Metropolitan City R. Co. v.	
etc. R. Co.	468, 469	Chicago West Div. R. Co.	267, 268
McGregor v. Dover, etc. R. Co.	435	Metropolitan Concert Co. v. Ab-	
v. Erie R. Co.	411	bey	312
McIntosh v. Flint, etc. R. Co.	272	Metropolitan El. R. Co. v. Man-	
McKee v. Chautauqua Assembly	87	hattan R. Co.	212, 338, 346, 356
McKusick v. Seymour, Saben &		Metropolitan Trust Co. v. Colum-	
Co.	249	bus, etc. R. Co.	365, 377
McLeary v. Erie Tel., etc. Co.	319,	Meyer v. Johnston	11, 14, 16, 18, 118,
382, 448		123, 264, 303	
McMahon v. Morrison	13, 115, 116,	v. Staten Island R. Co.	548
168		Meyers v. Merillion	668
McMillan v. Carson Hill Union		Michigan Central R. Co. v. Bul-	
Min. Co.	477, 480	lard	321
v. Michigan, etc. R. Co.	410, 414,	v. Pere Marquette R. Co.	325,
418		363	



# TABLE OF CASES

	PAGE		PAGE
Michigan Telephone Co. v. City of St. Joseph	274	Mobile, etc. v. State	154
Middlesex R. Co. v. Boston, etc. R. Co.	327, 443	Mogul Steamship Co. v. McGregor	559, 583, 591, 646
Midland R. Co. v. Great Western R. Co.	459	Monongahela River Con. Coal Co. v. Jutte	704
v. Manchester, etc. R. Co.	457	Monroe County Ill. v. Village of Mt. Gilead	597
v. Neath, etc. R. Co.	457	Monroe v. Fort Wayne, etc. R. Co.	110
Midland Great Western R. Co. v. Leech	15, 133	Monseaux v. Urquhart	514
Milbank v. New York, etc. R. Co.	474, 479, 504, 530, 551	Montague v. Lowry	707, 716, 718, 724, 726, 729, 754, 755, 756
Miles, Dr., Medical Co. v. Gold-thwaite	744	Montgomery, etc. R. Co. v. Bor-ing	128, 152
v. Jaynes Drug Co.	743, 744	v. Branch	167, 168, 248, 311
v. Platt	744	Montgomery Web Co. v. Dienelt	245, 250
Miles v. New South Building Ass'n	529	Monument Bank v. Globe Works	433
Milhau v. Sharp	267	Moore v. Mining Co.	223
Military Interstate Ass'n v. Savannah, etc. R. Co.	477, 509	Moorsheads v. United Rys. Co.	324, 338, 363, 397
Miller v. Consolidated Lake Superior Co.	220	Moran v. Pittsburg, etc. R. Co.	412
v. Green Bay, etc. R. Co.	468	Morgan v. King	220, 503, 507
v. Lancaster	116, 128, 131	v. Louisiana	266, 305, 306
v. New York, etc. R. Co.	391, 398	Morisette v. Howard	204, 215
v. Rutland, etc. R. Co.	265	Morrell v. Smith County	49, 51, 136, 147, 183
v. Wheeler, etc. Co.	188	Morrill v. Railroad Co.	64, 69
Mills v. Central R. Co.	21, 27, 82, 96, 97, 99, 327, 328, 336, 347, 350, 352	Morris v. Elyton Land Co.	215, 222, 224, 228, 229, 233
Miltenberger v. Logansport R. Co.	430	Morris Run Coal Co. v. Barclay Coal Co.	559, 590, 633, 645, 650, 655, 668, 669
Milwaukee, etc. R. Co. v. Brooks, etc. Works	428	Morrison v. American Snuff Co.	152
Miner v. Belle Isle Ice Co.	448	v. St. Paul, etc. R. Co.	324
Miners Ditch Co. v. Zellerbach	203, 236, 269, 433, 508	Morville v. American Tract Soc.	439
Mines v. Scribner	743	Moss v. Averell	202
Minneapolis, etc. R. Co. v. Gardner	116, 125, 138	Motter v. Kennett Tp. Electric Co.	56
Minnesota v. Northern Securities Co.	834, 846	Mowrey v. Indianapolis, etc. R. Co.	81, 85, 88, 89, 90, 97
Mississippi, etc. R. Co. v. Southern R. Ass'n	422	Moxie Nerve Food Co. v. Baumbach	519
Mississippi Valley R. Co. v. Chicago, etc. R. Co.	163	Mozley v. Alston	94, 222
Missouri, etc. R. Co. v. Carter	159	Mugler v. Kansas	790
v. Warner	310	Mullen v. Philadelphia Traction Co.	413
v. Sisson	833	Muller v. Dows	188, 197, 199
Missouri Pac. R. Co. v. Meeh	188, 189	Mumford v. Ecuador Devel. Co.	217
v. Morrow	416	Munn v. Illinois	786
v. Owens	27, 66, 166, 253, 303	Munson v. Syracuse, etc. R. Co.	90
v. Texas, etc. R. Co.	663	Muntz v. Algiers, etc. R. Co.	393
v. Watts	398, 402	Murch v. Concord R. Co.	398, 402, 418
Mitchell v. Deeds	32, 178, 330	v. Eastern R. Co.	411
v. Reynolds	605	Muscatine Western R. Co. v. Horton	299
Mobile, etc. R. Co. v. Gilmer	158	Myers v. Murray, etc. Co.	188

## TABLE OF CASES

N		PAGE		PAGE
Naglee v. Alexandria, etc. R. Co.	273,		New Hampshire Sav. Bank v. Richey	203, 240, 241
	301		New Haven, etc. Co. v. Linden	
Nantasket Beach S. S. Co. v. Shea	258,		Spring Co.	572
	313		New Jersey Midland R. Co. v. Strait	131, 132
Nashua, etc. R. Corp. v. Boston,			New Jersey Southern R. Co. v. Long Branch Commrs.	269
etc. R. Corp. 188, 189, 197, 198,	459,		Newland Hotel Co. v. Lowe	
	545, 663		Furniture Co.	477, 480
Nashville, etc. R. Co. v. Carroll	420		Newman v. Mercantile Trust Co.	537
Nashville, etc. Turnpike Co. v. Davison County	598		New Orleans, etc. R. Co. v. Dela-	
Nassau Bank v. Jones	257, 434, 474,		more	264, 303, 304
	479, 480		v. Harris	82, 92
Natchez, etc. R. Co. v. Lambert	141		New Orleans, etc. Steamship Co.	
Nathan v. Tompkins	94, 95, 223		v. Ocean Dry Dock Co.	477, 478,
National Bank v. Case	504, 505, 525			480
National Bank of Xenia v. Stewart	514		New Orleans Gas Light Co. v. Hart	791
National Cotton Oil Co. v. Texas	710,		v. Louisiana Light, etc. Co.	56,
	793, 799, 800, 805, 826			57, 118, 120, 142, 266, 268
National Distilling Co. v. Cream City Importing Co.	673, 675, 616		New York, etc. Canal Co. v. Fulton Bank	25, 566
National Enameling, etc. Co. v. Harberman	604		New York, etc. R. Co. v. New York, etc. R. Co.	48, 275, 282, 290,
National Fire Proofing Co. v. Master Builders' Ass'n	587			379, 423, 424, 425, 427, 428, 431,
National Folding Box, etc. Co. v. Robertson	675			660
National Foundry, etc. Works v. Oconto Water Co.	525		v. Offield	598
National Harrow Co. v. Bement	651,		v. Saratoga, etc. R. Co.	118
	656, 834		New York, etc. R. Co., In Matter of,	410
v. Hench	667, 740, 741, 742		New York Central, etc. R. Co. v. City of Yonkers	28, 53, 105,
v. Quick	675, 740, 742			118, 130
National Lead Co. v. Grote Paint Store Co.	582, 631, 637, 826, 838,		Niagara Fire Ins. Co. v. Cornell	796,
	840			801, 826
National Salt Co. v. Ingraham	838		Niantic Savings Bank v. Douglass	136
National Tube Works v. Ballou	248		Nibbs v. Chicago, etc. R. Co.	409
Natusch, v. Irving	98		Nichols v. Boston, etc. R. Co.	417
Naugatuck R. Co. v. Waterbury Button Co.	459		v. New Haven, etc. R. Co.	306
Navigation Co. v. Winsor	604		Nicoll v. New York, etc. R. Co.	202
Nebraska Shirt Co. v. Horton	477		Niles v. New York, etc. R. Co.	549
Neeley v. State	269		Nordenfelt v. Maxim-Nordenfelt Co.	603, 605
Nelson, <i>In re</i>	705		Norfolk, etc. R. Co. v. Pendleton	138, 140, 307
Nelson v. Vermont, etc. R. Co.	328,		North Carolina, etc. R. Co. v. Carolina Central R. Co.	304
	404		North Carolina R. Co. v. Drew	163
v. Railroad Co.	393		Northern Securities Co. v. United States	75, 693, 695, 701, 702, 703,
Nester v. Continental Brewing Co.	559, 599, 606, 641, 650, 652,			706, 709, 713, 723, 732
	655, 668, 672		Northern Transportation Co. v. Chicago	314
New Bedford R. Co. v. Old Colony R. Co.	167		Northwestern Mutual Life Ins. Co. v. Exchange Real Est. Co.	571,
New Buffalo v. Iron Co.	136			576
Newcastle Northern R. Co. v. Simpson	440		Northwestern Nat. Life Ins. Co. v. Hare	158
New England Trust Co. v. Abbott	513			

# TABLE OF CASES

	PAGE	P	PAGE
Northwestern Union Packet Co.		Pacific Factor Co. v. Adler	559, 651,
v. Shaw	257, 259		658, 669
Northwestern Warehouse Co. v.		Pacific R. Co. v. Atlantic, etc. R.	
Oregon R., etc. Co.	597	Co.	381
Norton v. Thomas	818, 819	v. Renshaw	133
Norwalk Savings Bank Co. v.		Pacific R. R. Cases	131, 178
Norwalk Metal Spinning Co.	508	Page v. Heineberg	202
Nugent v. Boston, etc. R. Co.	402	Paine v. Lake Erie, etc. R. Co.	128,
v. Railroad Co.	390, 397		147
v. Supervisors	79, 92, 93, 132,	Palmer v. Utah, etc. R. Co.	392
	136	Panhandle Nat. Bank v. Emery	249
Nye v. Storer	313	Park, John D., Sons Co. v. Nat.	
		Wholesale Ass'n	607, 744
O		Park v. New York, etc. R. Co.	423,
		424, 425, 426, 428, 526	
Oakdale Mfg. Co. v. Garst	645, 655	Parkersburg v. Brown	438, 440, 441
O'Bear Jewelry Co. v. Volfer	241	Parkinson v. West End St. R.	
O'Brien v. Musical, etc. Union	588	Co.	157
Occum Co. v. A. & W. Sprague		Parr v. Spartansburgh, etc. R.	
Mfg. Co.	313	Co.	395, 396
O'Connor Mining, etc. Co. v.		Parsons v. Tacoma Smelting, etc.	
Coosa Furnace Co.	219, 246	Co.	315, 318, 319, 320, 474, 477,
Oelbermann v. New York, etc. R.		482, 510, 521, 524, 530	
Co.	494, 524, 541, 551	Pastuer Vaccine Co. v. Burkey	810
Offield v. New York, etc. R. Co.	99	Patch v. Wabash R. Co.	197
Ogdensburg, etc. R. Co. v. Ver-		Patterson v. Portland Smelting	
mont, etc. R. Co.	433	Works	220
Ohio, etc. R. Co. v. Indianapolis,		v. Wabash, etc. R. Co.	469
etc. R. Co.	458, 459	Paul v. Baltimore, etc. R. Co.	192,
v. People	116, 189, 192, 195		197, 198
v. Weber	195, 196	v. Virginia	262
v. Wheeler	188, 193	Pauly v. Coronado Beach Co.	477,
Olcott v. International, etc. R.			481, 532
Co.	438, 440, 441	v. State Loan, etc. Co.	525
v. Tioga R. Co.	457	Peabody v. Flint	221, 225
Old Colony R. Co. v. Evans	202	v. Westerly Water Works	207
Oliver v. Rahway Ice Co.	513	Pearce v. Madison, etc. R. Co.	25, 81,
Olmstead v. Distilling, etc. Co.	619,		177, 444
	673	Pearsall v. Great Northern R.	
v. Vance, etc. Co.	515	Co. 44, 45, 46, 47, 58, 67, 71, 77, 81	
Olsen v. Smith	746	Pearson v. Concord R. Corp.	220, 470,
Oman v. Bedford Bowling Green		479, 500, 501, 538, 545, 547	
Stone Co.	256	Peik v. Chicago, etc. R. Co.	189, 196
Ontario Salt Co. v. Merchants		Pell's Case	573
Salt Co.	646, 655	Pender v. Lushington	216
Ophir Consol. Mines Co. v.		Pendery v. Carleton	235
Bryntesen	514	Peninsular R. Co. v. Tharp	108, 133,
Oregon, etc. R. Co. v. Oregonian			134
R. Co. 51, 275, 327, 329, 331, 334,		Penley v. Railroad Co.	160
335, 340, 341, 434, 436, 441, 453, 482		Pennison v. Chicago, etc. R. Co.	238,
Oregon Short Line R. Co. v.			301
Northern Pacific R. Co.	661	Pennsylvania, etc. R. Co. v. Har-	
Orient Ins. Co. v. Daggs	790	kins	131
Ottawa, etc. R. Co. v. Black	444	Pennsylvania v. Bay	748
Over v. Byram Foundry Co.	656, 818,	Pennsylvania Co. v. Ellett	394, 419,
	835		466, 467, 468
Overstreet v. Citizens Bank	19, 25	v. Erie, etc. R. Co.	410, 422

# TABLE OF CASES

	PAGE		PAGE
Pennsylvania Co. v. St. Louis, etc.		Père Marquette R. Co. v. Wabash	
R. Co.	275, 329, 335, 339, 340,	R. Co.	362, 364
	436, 437, 441, 445	Perin v. Megibben	298
Pennsylvania College Cases	29, 81, 87,	Perry v. Western North Carolina	
	135	R. Co.	395
Pennsylvania R. Co. v. Common-		Peshtigo Co. v. Great Western	
wealth	22, 68, 69, 71, 73, 77,	Tel. Co.	477, 478, 480, 532
	538, 539, 541, 544	Peters v. Boston, etc. R. Co.	325, 336
v. Gresø	466, 468, 469	v. Lincoln, etc. R. Co.	354
v. Pennsylvania, etc. R. Co.	527	v. Railroad Co.	307
v. St. Louis, etc. R. Co.	51, 188,	Petersburgh v. Petersburg, etc.	
197, 198, 327, 328, 434, 440, 444		R. Co.	140
v. Sly	411	Petition of New York, etc. R.	
Pennsylvania Transportation		Co., In Matter of	378
Co.'s Appeal	161	Pettibone v. United States	578
People v. Aachen Fire Ins. Co.	588,	Phelan v. Hazard	576
	685, 833, 846	Phoenix Fire, etc. Ins. Co. v.	
v. Albany, etc. R. Co.	338, 412	Tennessee	305, 306
v. American Sugar Ref. Co.	683	v. Western Union Tel. Co.	323
v. Ballard	206, 211, 212, 230, 449	Philadelphia, etc. R. Co. v. Ander-	
v. Boston, etc. R. Co.	77	son	418
v. Butler St. Foundry, etc.		v. Appeal Tax Court	408
Co.	798, 799, 801, 802, 810	v. Catawissa R. Co.	91, 124, 410
v. California College	203	v. Howard	118, 167
v. Chicago Gas Trust Co.	473,	v. Maryland	141, 195
479, 482, 494, 499, 500, 501, 502,		Philadelphia v. Thirteenth St.,	
538, 541, 577, 599, 601, 610, 621,		etc. Co.	50
653, 665, 684, 687		Phillips v. Aurora Lodge	313
v. Chicago Live Stock Exch.	681	v. Covington, etc. Bridge	
v. Colorado, etc. R. Co.	413	Co.	572
v. Erie R. Co.	426	v. Northern R. Co.	398
v. Feitner	408	v. Providence Steam	
v. Kerr	267	Engine Co.	211, 221
v. Louisville, etc. R. Co.	161	Phinzy v. Augusta, etc. R. Co.	12,
v. Met. El. R. Co.	356	89, 110, 117, 551	
v. Milk Exchange	651, 658, 681	Piatt v. Oliver	670
v. New York, etc. R. Co.	114, 117	Picard v. East Tennessee, etc. R.	
	121, 189, 196	Co.	305, 306
v. North River Sugar Ref.		Pick v. Northwestern R. Co.	150
Co.	70, 560, 563, 565, 566, 567,	Pickens v. Georgia R., etc. Co.	385
568, 569, 599, 614, 640, 643, 651,		Pidcock v. Harrington	750
666, 681, 683, 687		Pierce v. Commonwealth	26
v. O'Brien	69	v. Concord R. Corp.	416, 417
v. People's Gas Light Co.	28, 665	v. Emery	203, 263, 273
v. Pullman Car Co.	473, 480, 509	v. Fuller	604
v. Rice	50, 57	v. Milwaukee, etc. R. Co.	303
v. St. Louis, etc. R. Co.	413	v. North Carolina R. Co.	395
v. Sheldon	581, 591, 640, 650, 658	v. Old Dominion Copper Min.,	
v. Stanford	291	etc. Co.	548
v. Wemple	57	Pierson v. McCurdy	480
People's Pass. R. Co. v. Memphis		Pinchback v. Bessemer Mining	
R. Co.	267, 268	Co.	204, 226
Peoria, etc. R. Co. v. Chicago,		Pingree v. Michigan Central R.	
etc. R. Co.	430	Co.	15
v. Coal Valley Mining Co.	26, 155,	Pinkerton v. Philadelphia Trac-	
	273	tion Co.	398
v. Lane	394, 466, 468	Pinkney, In re	824
Peoria Gas, etc. Co. v. Peoria	839	Pinkus v. Minneapolis Linen Mills	225

## TABLE OF CASES

li

# TABLE OF CASES

	PAGE		PAGE
Railroad Co. v. Mathers	366	Rodgers v. Wells	133, 134
v. Palmer	305	Rogers v. Nashville, etc. R. Co.	258,
v. Whitton	189, 197	275, 329, 345, 519, 520, 524,	548
v. Wood	387, 390	Rogersville, etc. R. Co. v. Kyle	300
Railway Co. v. Allerton	345, 522	Rollins v. Shaver Co.	513
v. Campbell	388	Roman v. Dimmick	576
v. Dunbar	392	Rome, etc. R. Co. v. Chasteon	392
v. Keokuk Bridge Co.	367, 440	Roper v. McWhorter	328
v. Neel	462	Rosenkrans v. Lafayette, etc. R.	
Raleigh v. North Carolina R.		Co.	156
Co.	395	Rothschild v. Memphis, etc. R.	
Ramsey v. Gould	216	Co.	218
Rand, McNally & Co. v. Hartranft		Rothwell v. Robinson	211
	832	Rourke v. Elk Drug Co.	580, 848
Randall v. Detroit, etc. R. Co.	250,	Rouse v. Merchants' Nat. Bank	239
	310	Rousillon v. Rousillon	605
Ray v. Pecos, etc. R. Co.	467	Royal Bank of India's Case	504, 505,
Read v. Citizens St. R. Co.	229	524, 525	
Reed v. Southern R. Co.	389, 401	Royal British Bank v. Turquand	433
Rehberg v. Tontine Surety Co.	242	Rubber Tire Wheel Co. v. Mil-	
Reichwald v. Commercial Hotel		waukee Rubber Works Co.	740, 741
Co.	213, 226, 299, 571	Rubins v. Pressed Steel Car Co.	496
Reid v. Trowbridge	598	Runyan v. Coster's Lessee	451
Reiff v. Western Union Tel. Co.	324	Russell v. Fuel Gas Co.	219
Reynolds v. Cridge	300	Rutland R. Co. v. Central Ver-	
v. Stark County Comm'rs	203	mont R. Co.	407
Rice v. Norfolk	309	Rutter v. Union Pacific R. Co.	162
v. Rockefeller	569, 617	Ryan v. Leavenworth, etc. R. Co.	505,
v. Standard Oil Co.	755	510	
Richards v. Merrimack, etc. R.		Ryerson v. Morris Canal, etc.	
Co.	253, 330	Co.	385
Richardson v. Buhl	599, 623, 642, 651,		
	669		
v. Mellish	610		
v. Sibley	273, 280, 299, 300		
Richelieu Hotel Co. v. Inter-			
national, etc. Co.	509		
Richmond, etc. R. Co. v. Durham			
etc. R. Co.	456		
Ricketts v. Chesapeake, etc. R.			
Co.	328, 392		
Ridgway Township v. Griswold	94,		
	116, 124, 128, 132		
Riggs v. Pursell	373		
Rio Grande R. Co. v. Telluride			
Power, etc. Co.	106, 116, 118		
Ritchie v. People	789, 792		
Robertson v. Parks	581		
v. Rockford	128, 136		
Robinson v. Beel	514		
v. Holbrook	493, 560		
v. Southern Nat. Bank	505, 533		
v. Suburban Brick Co.	720		
Robotham v. Prudential Ins. Co.	474,		
	492, 494, 546, 547, 550		
Rochester, etc. R. Co., Matter of	510		
Rochester R. Co. v. City of			
Rochester	227, 306		

## S

Safety Insulated Wire, etc. Co. v.	
Baltimore	434
Sage v. Culver	446, 548
v. Lake Shore, etc. R. Co.	189,
	195
St. Joseph Plank Road Co. v.	
Klein	508
St. Joseph, etc. R. Co. v. Hum-	
phreys	425, 426, 428
v. St. Louis, etc. R. Co.	367
St. Louis, etc. Drayage Co. v.	
Louisville, etc. R. Co.	659
St. Louis, etc. R. Co. v. Balsley	261
v. Berry	44, 121, 138, 139, 143
v. Cleveland, etc. R. Co.	430
v. Curl	387, 390, 391, 397, 418
v. Evans	389
v. Gill	307
v. Indianapolis, etc. R. Co.	197,
	198
v. James	188
v. Marker	160
v. Miller	156, 166

# TABLE OF CASES

	PAGE		PAGE
St. Louis, etc. R. Co. v. Paul	788, 790	Selkir v. Klein	57
v. Ritz	404	Sellers v. Richmond, etc. R. Co.	467
v. Rowley	468	Sellers v. Union Lumbering Co.	266
v. Terre Haute, etc. R. Co.	49,	Selma, etc. R. Co. v. Harbin	128, 172
50, 51, 92, 275, 327, 329, 350,	350,	Seney v. Wabash Western R. Co.	425, 427
351, 352, 434, 437, 438, 440,	440,		
454	454	Sewell v. East Cape May Beach	
St. Louis Carriage Mfg. Co. v.		Co.	211, 300
Hilbert	511	Seymour v. Spring Forest Cem.	
St. Paul, etc. R. Co., <i>In re</i>	189	Ass'n	576
St. Paul, etc. R. Co. v. Parcher	305	Shackleford v. Miss. Cent. R. Co.	170
St. Paul Trust Co. v. Wampach		Shadford v. Detroit, etc. R. Co.	20,
Mfg. Co.	509		152, 181
Salt Lake City v. Hollister	440, 441	Shaffer v. Union Mining Co.	788
Salt Lake Hardware Co. v. Tintic		Shamokin Valley R. Co. v. Liver-	
Mill Co.	576	more	256
San Antonio Gas Co. v. State	665,	Shannon v. Stevenson	572
	683, 829	Shapley v. Atlantic, etc. R. Co.	265
San Antonio Traction Co. v. Alt-		Shaw v. City of Covington	142
gelt	138	v. Davis	318, 448
Sanford v. People	588, 642, 835	v. Norfolk County R. Co.	145,
San Francisco, etc. R. Co. v. Bee	244		162, 330
San Francisco v. Spring Valley		v. Quincy Mining Co.	188
Water Works	159	Shawnee Compress Co. v. Ander-	
Santa Clara Valley Mill, etc. Co.		son	316, 606, 637, 704, 706
v. Hayes	559, 644, 648, 651, 655	Shelbyville, etc. Turnpike Co. v.	
Sappington v. Little Rock, etc. R.		Barnes	27, 92
Co.	158, 161, 238, 309	Sheldon, etc. Co. v. Eickemeyer,	
Sargent v. Webster	213	etc. Co.	214, 224
Sartison v. Baltimore, etc. R. Co.	19,	Shepley v. Atlantic, etc. R. Co.	330
	309	Shepp v. Schuykill Valley	
Saugatuck Bridge Co. v. Town of		Traction Co.	543
Westport	299	Shield v. Clifton Hill Land Co.	572
Savannah, etc. R. Co. v. Jack-		Shields v. Ohio	27, 28, 115, 116,
sonville, etc. R. Co.	428		117, 121, 138, 143, 150, 522
Savings & Trust Co. v. Bear		Shoemaker v. National Mech.	
Valley Irr. Co.	237	Bank	504
Savings Bank v. Wulfekuhler	512	v. Washburn Lumber Co.	515
Sawyer v. Dubuque Printing Co.	230	Shores v. Southern R. Co.	391, 419
Scattergood v. Edge	343	Shreveport Traction Co. v.	
Schaaake v. Eagle Automatic Can		Kansas City, etc. R. Co.	78
Co.	234	Shrewsbury, etc. R. Co. v. Lon-	
Schenck v. Andrews	576	don, etc. R. Co.	663
Schermerhorn v. Vanderheyden	382	v. Stour Valley R. Co.	15, 106
Schleider v. Dielman	248	Simmons v. Troy Iron Works	257
Schmidt v. Louisville, etc. R.		v. Terry	819
Co.	368, 373	Simpson v. Denison	327, 340, 459
Schofield v. Goodrich Bros. Bank-		v. Westminster, etc. Hotel	
ing Co.	474, 534	Co.	313
Schufeldt v. Smith	241	Sinclair v. Missouri, etc. R. Co.	466,
Scotland County v. Thomas	135,		468, 469
	136, 137	Singer v. Hutchinson	239
Scott v. Farmers, etc. Bank	73	Singleton v. Southwestern R. Co.	253,
v. Hanshear	136		273, 280, 327, 394, 396, 404
v. Neeley	248	Sioux City Terminal R., etc. Co.	
Scribner v. Straus	743, 747	v. Trust Co. of North America	303
Searight v. Payne	572	Skinner v. Smith	211, 316
Seaton v. Grant	223	Skrainka v. Scharringhausen	559, 654

# TABLE OF CASES

	PAGE		PAGE
Slack v. Northwestern Nat. Bank	242	Southern R. Co. v. Allison	197
Slughter v. Thatcher Coal, etc. Co.	642, 655	v. Ensign Mfg. Co.	406
Slaughter House Cases	593, 594	v. Franklin, etc. R. Co.	363, 368, 374, 384
Sliddell v. Grandjean	334	v. Mitchell	276
Slossen v. Burlington, etc. R. Co.	416	v. North Carolina R. Co.	412
Small v. Minneapolis, etc. Co.	314, 319, 680	v. Puckett	309
Smalley v. Atlantic, etc. R. Co.	392	Southgate v. Atlantic, etc. R. Co.	173
Smiley v. Kansas	793, 805, 806, 810	South Side, etc. R. Co. v. Second Ave. R. Co.	378, 460
Smith v. Berndt	313	Southwestern R., etc. Co. v. Georgia	137, 139
v. Bromley	435	South Yorkshire v. Great Northern R. Co.	458
v. Chesapeake, etc. Canal Co.	29	Spangler v. Atchison, etc. R. Co.	419
v. Clark County	136, 137	Spargo's Case	572, 573
v. Ferries, etc. R. Co.	221	Sparrow v. Evansville, etc. R. Co.	31, 79, 80, 133
v. Hurd	355	Spear v. Crawford	202
v. Lake Shore, etc. R. Co.	191	Spencer v. Seaboard Air Line R. Co.	96, 98
v. Los Angeles, etc. R. Co.	153	v. World's Columbian Expo- sition	430
v. Newark, etc. R. Co.	477, 500, 501, 525	Sprague v. Illinois River R. Co.	81, 133
v. New York Consolidated Stage Co.	212	v. National Bank	576
v. People	578	v. Smith	417, 418
v. Reading City Pass. R. Co.	53	Springer v. Chicago Real Estate, etc. Co.	202
Smith Lumber Co., <i>In re</i>	513	Springfield Fire, etc. Ins. Co. v. Cannon	675
Snell v. City of Chicago	300	Spring Valley Water Co. v. Schottler	266, 522
Snow v. Boston, etc. R. Co.	225	Staltz v. Baltimore, etc. R. Co.	419
Society for Savings v. Coite	265	Standard Oil Co. v. State	583, 809, 810, 811, 814, 815, 835, 844
Solomonovich v. Denver Cons. Tramway Co.	120, 122	Stanley v. Cleveland, etc. R. Co.	457
Solomons v. Laing	539	Stanton v. Allen	601, 642, 670
South, etc. R. Co. v. Highland, etc. R. Co.	465	Starke v. J. M. Gaffey Petroleum Co.	313, 315
Southall v. British Mutual Life Assur. Soc.	233	State v. Ætna Fire Ins. Co.	828, 846
South and North Alabama R. Co. v. Highland Ave., etc. R. Co.	258	v. American Cotton Oil Trust	569, 685
South Carolina, etc. R. Co. v. Augusta, etc. R. Co.	325, 362, 363,	v. Armour Packing Co.	555, 643, 687, 815, 846, 851
v. Carolina, etc. R. Co.	375	v. Associated Press	790, 811, 828
South Carolina R. Co. v. Blake	145	v. Atchison, etc. R. Co.	22, 53, 59, 64, 65, 66, 77, 327, 335, 448, 449
v. Wilmington, etc. R. Co.	463	v. Bailey	27, 92, 97, 116
South Carolina Terminal Co. v. South Carolina, etc. R. Co.	325, 460	v. Baltimore, etc. R. Co.	159, 166
South Devon R. Co. v. Devon, etc. R. Co.	457	v. Bank of Maryland	226
Southern Electric Securities Co. v. State	566, 640, 653, 681, 683, 812, 827, 829, 850	v. Bartlett	578
Southern Indiana Exp. Co. v. United States Exp. Co.	660, 738, 749	v. Beck	27
Southern Kansas R. Co. v. Sage	390, 470	v. Buckeye Pipe Line Co.	795, 840
Southern Pacific R. Co. v. Esqui- bel	289	v. Butler	474, 480
		v. Central Iowa R. Co.	413



# TABLE OF CASES

	PAGE		PAGE
State v. Central R. etc. Co.,	449, 498	State v. New Orleans Warehouse	
v. Chicago, etc. R. Co.	305, 311	Co.	313, 321
v. Cincinnati Gas Light		v. Northern Central R. Co.	138
Co.	266	v. Oberlin Building Ass'n	511,
v. Commr. of Railroad Taxa-			512
tion	140	v. Omaha Elevator Co.	774, 820,
v. Consolidated Gas Co.	107		847, 851
v. Consolidation Coal Co.	272,	v. Pawtuxet Turnpike Co.	302
	280, 290	v. People's United States	
v. Continental Tobacco	636, 813,	Bank	541
	851	v. Philadelphia, etc. R. Co.	139,
v. Crawfordsville, etc. Turn-			141
pike Co.	177	v. Phipps	810, 824, 825, 826, 847
v. Cudahy Packing Co.	773, 798,	v. Portage City Water Co.	266,
	799		268
v. Dodge	450	v. Portland Natural Gas, etc.	
v. Dreany	587, 588, 844	Co.	642, 644, 665, 683, 684
v. East 5th St. Co.	264, 267, 268	v. Richmond, etc. R. Co.	337
v. Firemen's Fund Ins. Co.	555,	v. Rives	253
583, 667, 794, 808, 823, 826,	832,	v. Robb	598
	850	v. Rohlfss	508, 524
v. Gage	804	v. St. Paul, etc. R. Co.	449
v. Glidden	579	v. St. Paul Gas Light Co.	829
v. Greene County	136	v. Schlitz Brewing Co.	795, 799,
v. Higby Co.	513		826, 846, 847, 849
v. Housatonic R. Co.	324, 408	v. Sherman	19, 116, 265
v. Huegin	835	v. Shippers Compress Co.	799,
v. International Harvester Co.			800, 832, 851
	803, 836	v. Simmons Hardware Co.	803
v. Jack	794, 803, 833	v. Smiley	606, 789, 794, 809, 811,
v. Jacksonville R. Co.	267, 268		820
v. Jacobs	804, 809	v. Smith	513, 514
v. Keokuk, etc. R. Co.	116, 121,	v. So. Kansas R. Co.	414
	143	v. Standard Oil Co.	71, 560, 564,
v. Lancashire Fire Ins. Co.	810,	565, 566, 567, 616, 651, 683, 684,	
	828		687, 826, 847, 851
v. Laredo Ice Co.	799, 804, 835	v. Topeka Water Co.	274
v. Lesuer	150	v. U. S. Grant University	227
v. McDaniel	530, 545	v. Vanderbilt	21, 53, 54, 55, 59
v. McMinnville, etc. R. Co.	431,		73, 77, 109, 179
	443	v. Virginia-Carolina Chem-	
v. Maine Central R. Co.	116, 120,	ical Co.	795, 809, 826, 836
	129, 142	v. Waters-Pierce Oil Co.	845, 847
v. Minnesota Central R. Co.	302	v. Western Irrigating Canal	
v. Minnesota Thresher Mfg.		Co.	204, 262, 264, 266
Co.	269, 681	v. Wilson	822, 835, 837
v. Missouri, etc. R. Co.	793, 796,	v. Witherspoon	795, 799, 844
804, 829, 833, 845, 864		v. Woodruff	141
v. Mobile, etc. R. Co.	412, 413	State Treasurer v. Auditor Gen-	
v. Montana R. Co.	12, 16, 21, 67,	eral	27
	327	Stearns v. Atlantic, etc. R. Co.	388
v. Morgan	304	v. Morse	358
v. Mut. Gas Light Co.	266	Stephens v. Davenport, etc. R.	
v. Nashville, etc. R. Co.	306	Co.	415, 419
v. Nebraska Distilling Co.	607,	v. Southern Pacific Co.	375
618, 642, 650, 683, 687		Sterling Remedy Co. v. Wyckoff	833
v. Nemaha County Commrs.	136	Stetler v. Chicago, etc. R. Co.	470
v. Newman	524, 530	Stevens v. Davison	346

# TABLE OF CASES

	PAGE		PAGE
Stevens v. Missouri, etc. R. Co.	185	Tait v. Bigott	515
v. Rowe	581	Talmage v. Pell	474, 500, 502, 504, 505
v. Rutland, etc. R. Co.	82, 90, 216, 221	Tanner v. Lindell Railroad Co.	96, 210, 216, 220, 222, 225, 297
Stewart's Appeal	161, 281	Tarpey v. Deseret Salt Co.	129, 178
Stewart v. Chicago, etc. R. Co.	415	Taylor v. Blanchard	604
v. Erie, etc. Transportation Co.	612, 659, 677, 678	v. Bowker	248
v. Lehigh Valley R. Co.	454	v. Chichester, etc. R. Co.	205
v. Long Island R. Co.	337	v. Earle	230, 508
Stickley v. Chesapeake, etc. R. Co.	391, 420	v. Montreal Harbor Commrs.	597
Stikeman's Will, <i>In re</i>	148	v. North Star Gold Mining Co.	508
Stock Discount Co. v. Brown	475	v. Railroad Co.	225, 351
Stockton v. American Tobacco Co.	681, 685	v. Salmon	221
v. Central R. Co.	327, 450, 451, 454, 685	v. Southern Pacific Co.	524
Stokes v. Detrick	215	Tecumseh, etc. Bank v. Russell	479
Strait v. National Harrow Co.	740	Tecumseh National Bank v. Best	242
Straus v. American Publishers Ass'n	743, 823	Tennessee v. Whitworth	128, 137, 138, 306
Strickland v. National Salt Co.	496, 577, 675	Terhune v. Midland R. Co.	184
Sturges v. Knapp	374	Terre-Haute, etc. R. Co. v. Cox	330, 379, 380
Summers v. Glenwood Gold, etc. Min. Co.	230, 245	v. Earp	133
Sumner v. Marcy	473, 480	v. Peoria, etc. R. Co.	459, 461
Sunflower Oil Co. v. Wilson	425	Terrill, <i>In re</i>	707, 752
Susquehanna Bridge Co. v. General Ins. Co.	357	Texas, etc. R. Co. v. Murphy	160
Susquehanna Canal Co. v. Bonham	255	v. Southern Pacific Co.	667
Sussex R. Co. v. Morris, etc. R. Co.	659	Texas Brewing Co. v. Anderson	796
Swan v. Scott	674	v. Durrum	796
Swan Land Co. v. Frank	247, 299	v. Meyer	819
Swansea, etc. R. Co. v. Swansea, etc. R. Co.	457	v. Templeman	819
Swartwout v. Mich. Air Line R. Co.	135, 170	Texas Cent. R. Co. v. Lyons	309
Sweeney v. Grape Sugar Refining Co.	219, 246	Texas Standard Oil Co. v. Adoue	73, 559, 641, 643, 646, 647, 651, 655
Swice v. Maysville, etc. R. Co.	402	Thayer v. Flint, etc. R. Co.	308
Swift v. United States	713, 716, 724, 725, 726, 727, 729	The Elevator Case	374
Swing v. American Glucose Co.	152	Thomas v. Cincinnati, etc. R. Co.	371, 739
Swords v. Edgar	391	v. Citizens R. Co.	351
Symmes v. Union Trust Co.	222, 224	v. Railroad Co.	26, 327, 328, 329, 331, 339, 340, 434, 436, 437
Syracuse, etc. R. Co., <i>Re</i>	225	Thompson v. Abbott	128, 152
		v. New York, etc. R. Co.	269
		v. Waters	202
		Thomsen v. Union Castle Mail S.S. Co.	757
		Threadgill v. Pumphrey	303
		Thrift v. Elizabeth City	596
		Thorne v. Lehigh Valley R. Co.	387, 415
		Thorpe v. Rutland, etc. R. Co.	791
		Thousand Island Park Ass'n v. Tucker	597
Taff Vale R. Co. v. Ryhmney R. Co.	457	Tillinghast v. Carr	536
Tagart v. Northern Cent. R. Co.	192, 157	Tippecanoe Co. v. Lafayette, etc. R. Co.	51

# TABLE OF CASES

	PAGE		PAGE
Tod v. Kentucky Union Land Co.	11, 499, 505, 545	Tulare Irr. Dist. v. Kaweah Canal, etc. R. Co.	301
Tode v. Gross	605	Turner v. Stip	358
Todhunter v. Des Moines, etc. R. Co.	343	Turnpike Co. v. Illinois	334
Toledo, etc. R. Co. v. Dunlap	146, 194	Turnpike Road Co. v. Campbell	266, 268
v. Rumbold	387, 415, 418, 466, 468, 469	Tuscaloosa Ice Mfg. Co. v. Williams	655
Toler v. East Tennessee, etc. R. Co.	527, 529	Tuttle v. Michigan Air Line Co.	82, 179
Tomlinson v. Branch	17, 128, 139, 141, 154	Tysen v. Wabash, etc. R. Co.	164
Tompkins v. Augusta Southern R. Co.	152, 158, 160		
Topeka Paper Co. v. Oklahoma Pub. Co.	177	U	
Tourtelot v. Whithed	502	Underwood v. Barker	605
Town of Lakeview v. Rose Hill Cemetery Co.	791	Union, etc. Ass'n v. Masonic Hall Ass'n	508
Town of Middletown v. Boston, etc. R. Co.	349	Union Bank of Chicago v. Kansas City Bank	423
Town of Pana v. Lippincott	136	Union Bridge Co. v. Troy, etc. R. Co.	357, 441
Town of Westbrook's Appeal from Commissioners	410	Union Pacific R. Co. v. Chicago, etc. R. Co.	321, 322, 357, 359, 361, 365, 433, 456, 458, 459, 461, 465
Townsend v. St. Louis, etc. Mining Co.	250	v. Gouchenour	131
Tracy v. Talmadge	434	v. McAlpine	164, 238
v. Troy, etc. R. Co.	415	Union Pressed Brick Co. v. Chicago Hydraulic Pressed Brick Co.	589, 850
Traer v. Prospecting Co.	206	Union Sewer Pipe Co. v. Connolly	718
Trask v. Maguire	305	Union Trust Co. v. Atchison, etc. R. Co.	666
v. Peekskill Plow Works	112	v. Illinois Mid. R. Co.	309
Treadgill v. Pumphrey	273, 303	United Lines Tel. Co. v. Boston Safe Deposit Co.	520
v. Salisbury Mfg. Co.	207, 208, 211, 216, 231, 538	United New Jersey R., etc. Co. v. Hapgood	168
Trenton Pass. R. Co. v. Wilson	185	United States v. Addyston Pipe, etc. Co.	602, 604, 728, 753, 759, 760
Trenton Potteries Co. v. Olyphant	605, 636, 638, 645, 655, 657	v. Cassidy	578, 579
Trenton St. Ry. Co., <i>In re</i>	146	v. Chesapeake, etc. Fuel Co.	712, 718, 728
Trester v. Missouri, etc. R. Co.	146, 189, 194	v. Coal Dealers Ass'n	691, 701, 708, 718, 728, 751
Trevor v. Whitworth	511, 512	v. Debs	714, 730
Trimm v. Marsh	373	v. E. C. Knight Co.	614, 643, 649, 712, 715, 716, 717, 718, 719, 720, 724, 725, 784
Tripp v. North Western Nat. Bank	213	v. Elliott	739, 750
Trisconi v. Winship	208	v. Greenhut	707, 752
Troup v. Horbach	572, 576	v. Hopkins	691, 760
Troy, etc. R. Co. v. Boston, etc. R. Co.	272, 280, 338	v. Jellico Mountain Coal, etc. Co.	678, 718, 728
v. Kerr	300, 327, 444	v. Joint Traffic Ass'n	693, 696, 697, 703, 708, 716, 718, 735, 788
Troy Buggy Works v. Fife	819		
Troy v. Rutland R. Co.	274		
Trust Co. v. State	498		
Trust Co. of North America v. Manhattan Trust Co.	384		
Tuckahoe Canal Co. v. Tuckahoe, etc. R. Co.	269, 279		

## TABLE OF CASES

lviii

# TABLE OF CASES

	PAGE		PAGE
Washburn v. National Wall Paper Co.	571, 573, 574	Wheeler-Stenzel Co. v. Nat. Glass Jobbers Ass'n	708, 724, 754, 757
Washington v. Northern Securities Co.	70	Whipple v. Union Pacific R. Co.	166, 169
Washington St., etc. R. Co., Matter of	50	White, S. S., Dental Mfg. Co. v. Hertzberger	810
Wasmer v. Delaware, etc. R. Co.	419	White v. Albany R. Co.	375
Waters-Pierce Oil Co. v. State	795, 796, 799, 810, 826, 845, 847, 850, 852	v. Buss	434
v. Texas	826, 827	v. Franklin Bank	439
Watson v. Harlem, etc. Nav. Co.	553	v. Marquardt	503
v. Richmond, etc. R. Co.	418, 419	v. Syracuse, etc. R. Co.	547
Watt's Appeal	509	White Mountains R. Co. v. White Mountains R. Co.	300
Weatherby v. Baker	239, 572, 576	White Star Line v. Star Line	737
Webb v. Portland, etc. R. Co.	468	White Water, etc. Co. v. Valette	203, 330,
Wehrhane v. Nashville, etc. R. Co.	506	Whitman v. Watkin	493
Weiboldt v. Standard Fashion Co.	817	Whitney Arms Co. v. Barlow	259
Welch v. Phelps, etc. Windmill Co.	817	Whitney v. Atlantic, etc. R. Co.	387
Welden Nat. Bank v. Smith	370, 382, 392	v. Mayo	221
Wells v. Missouri Edison El. Co.	151	v. Slayton	604
v. Rodgers	110, 111, 132	Whittaker v. Howe	605
Wells Richardson v. Abraham	744	Whittendon Mills v. Upton	566
Welsh v. Old Dominion Min. & R. Co.	264	Whitwell v. Continental Tobacco Co.	713, 756
Wentworth v. Braun	237	Wiggins Ferry Co. v. Ohio, etc. R. Co.	325
Werle v. Northwestern Flint, etc. Co.	209, 211	Wilbur v. Trenton Pass. R. Co.	128
West End, etc. R. Co. v. Dameron	301	Wiley v. Nat. Wall Paper Co.	675
West River Bridge v. Dix	269	Wilkinson v. Banerle	213
West Virginia Transportation Co. v. Ohio River Pipe Line Co.	654, 666	Williamson v. New Jersey Southern R. Co.	105, 163, 181, 528
v. Standard Oil Co.	579, 582	Williard v. Spartansberg	402
Western, etc. R. Co. v. Cox	419	Wills v. Central Ice, etc. Co.	586, 589, 820
v. Johnstown	255	Wilmington, etc. R. Co. v. Alsbrook	305, 306
v. Smith	152	Wilmington R. Co. v. Reid	81
Western Pennsylvania R. Co. v. Johnston	254	Wilmington Water Power Co. v. Evans	262
Western Union R. Co. v. Smith	156	Wilson v. Æolian Co.	231, 236, 250, 251
Western Union Tel. Co. v. American Union Tel. Co.	666	v. Central Bridge Co.	208, 220
v. Burlington, etc. R. Co.	666	v. Gaines	305
v. Chicago, etc. R. Co.	666	v. Morse	640, 851
v. Pennsylvania R. Co.	666	v. Salamanca	79, 137
v. Union Pacific R. Co.	323	Wilson's Case	508
Western Woodenware Ass'n v. Starkie	655	Winch v. Birkenhead, etc. R. Co.	49, 222, 274, 329, 350
Whaley v. Bankers Union of the World	175, 189	Winchester, etc. R. Co. v. Commonwealth	413
		Windmuller v. Standard Distilling, etc. Co.	524
		Winnebago, the	806
		Winsor v. Bailey	223
		Wisconsin Central R. Co. v. Ross	471
		Wittenberg v. Mollyneaux	657

# TABLE OF CASES

	PAGE		PAGE
Wolf v. Arminus Copper Mine Co.	212	Wylie v. National Wall Paper Co.	839
v. Pennsylvania R. Co.	376, 448	Wyman v. American Powder Co.	572
Wolverhampton, etc. R. Co. v. London, etc. R. Co.	465		
Wood v. Bedford, etc. R. Co.	289,	Y	
290, 341		Yates v. Van De Bogert	256
v. Dummer	239	Yazoo, etc. R. Co. v. Adams	17, 44,
v. Macon, etc. R. Co.	280	113, 114, 115, 116,	
v. Whitehead	605	121, 138, 140, 305	
Woodberry v. McClurg	497	v. Scarles	542, 636, 809, 813,
Woodcock v. First National Bank	537	830	
Woodruff v. Erie R. Co.	33, 59, 338,	v. Southern R. Co.	292
426, 428, 435, 442		Yentes v. Illinois Cent. R. Co.	397,
Wood, Walter A., Mowing, etc. Co. v. Greenwood Hardware Co.	642, 814, 818	309	
Woods v. Lawrence County	262	York, etc. R. Co. v. Winans	253, 273,
Woolfolk v. January	572	274	
Wormser v. Metropolitan St. R. Co.	337, 338, 447	Young v. Erie Iron Co.	572, 576
Worth Mfg. Co. v. Bingham	220, 223	v. Railroad Co.	298
Worthen v. Griffith	241	v. Rondout, etc. Gas Light Co.	90
Wragg, <i>Re</i>	572, 576	v. Toledo, etc. R. Co.	297
Wright v. Bundy	213	v. Webster City, etc. R. Co.	263
v. Kentucky, etc. R. Co.	357	Youngman v. Elmira, etc. R. Co.	254,
v. Lee	173, 537	255	
v. Milwaukee, etc. R. Co.	264,	Z	
267, 268		Zabriskie v. Cleveland, etc. R. Co.	221, 351, 433
v. Orville Mining Co.	548	v. Hackensack R. Co.	85, 90, 208,
v. Pipe Line Co.	259, 537	347	
v. Rider	603, 604	Zimmer v. Stato	44, 143

## INTERCORPORATE RELATIONS





# INTERCORPORATE RELATIONS

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## PRELIMINARY

§ 1. A corporation is an artificial person created by law having, within the limits of its chartered powers, the rights of a natural person in the transaction of business. It is governed by the general rules of law relating to rights of property, contracts and torts which apply to individuals. Its relations with other corporations, as *persons*, are essentially the same as the relations of natural persons.

A corporation is something other than a person. It possesses the property of immortality — the capacity of perpetual succession — and may act with certainty in reference to the future. Its possibilities of material development, through the increase and disposition of shares, may be as unlimited as its duration. Its methods of control and management are regulated by rules applicable to it alone. While the relations of corporations with each other as persons are like those of individuals, the relations of corporations as *corporations* are essentially different. The welding of several corporations into one, the selling and leasing of corporate franchises, the acquiring of controlling stock interests, the combining of corporate properties — all are governed by principles of law either inapplicable or applying in different degree to the relations of individuals.

Intercorporate relations of this character grow out of a variety of processes which may be classified as follows:

I. The union of stockholders, properties and franchises of several corporations in a single corporation — *consolidation*.

II. The absolute transfer of the franchises and property of one corporation to another — *sale*.

III. The transfer for stated payments of the franchises and property of one corporation to another in perpetuity or for a term of years — *lease*.

IV. The acquisition by one corporation of shares of the capital stock of another — *corporate stockholding*, which becomes *control* when a majority of the shares is acquired.

V. The coöperation of several corporations to accomplish a given purpose — *combination*.

§ 2. The consolidation of corporations is chiefly exemplified by railroad companies and, to a far less degree, by other *quasi*-public corporations, where the transmission of the franchise is of essential importance, and where the statutory method of effecting such transfer must be strictly followed.

The consolidation of railroad companies, occasioned by their peculiar nature and use, has been taking place for a long time. In their early days, the extraordinary powers granted to them — the right to condemn lands, take tolls and exclude all other cars from their tracks<sup>1</sup> — and their constantly developing necessity to the life of the people, led the legislatures to jealously guard the granting of authority to transfer the powers so intrusted. But it soon became apparent that the uniting of short connecting roads into through lines brought about increased facilities for travel and lower rates, and authority to consolidate came to be granted by special laws in particular

<sup>1</sup> But in the very earliest days of railroad companies, they were regarded both in England and this country as merely owners of roads upon which rails were placed, and upon which all persons had a right to operate their vehicles upon payment of tolls. The railroad was considered a public highway for independent carriers. Thus the charter of the Ithaca and Oswego railroad, granted in 1828, provided that "all persons paying the toll aforesaid may, with suitable and proper carriages, use and travel upon said railroad." Still it was usual to authorize the railroad company to act, with others, as a carrier upon its own road. But it had no such right without special authorization.

Economic principles, however, soon changed these early views. While independent carriers might possibly have been able to furnish cars for the transportation of goods upon the railroads, it was quite a different matter to obtain the motive power. Few carriers or shippers required or could afford a locomotive. Trains run by different managements upon the same road would be dangerous. Independent carriers could not serve the public with facility nor without duplication of expense. Safety, convenience and economy compelled the railroad company to exclusively operate its own road.

cases. Special acts were followed by general laws until, at the present time, the public policy of nearly all the States, as indicated by their statutory provisions, is in favor of the consolidation of connecting railroads which are neither competing nor parallel. Under this policy railroad consolidations have taken place in constantly increasing numbers. The greater companies have absorbed the smaller roads; the local roads have been united into the through line; the through line has become a part of the railway system.

§ 3. The relation of vendor and vendee between corporations as constantly arising in the ordinary transaction of business, is manifestly governed by general legal principles applicable both to individuals and corporations. But while an individual without restraint may sell and dispose of all his property, the right to sell all its assets and render itself incapable of performing the functions for which it was created exists in a *quasi*-public corporation only when expressly conferred by legislative authority, and may be exercised by a strictly private corporation only by the unanimous consent of its stockholders or as a means of liquidation.

The sale of corporate property for stock in the purchasing corporation — a familiar process in modern industrial enterprises — involves not only the power of the vendor corporation to take the stock, but the right of its minority stockholders to object to the embarkation of corporate assets in new adventures.

The sale of corporate franchises, especially those of railroad companies, has been illustrated most frequently by judicial sales under mortgage foreclosures, but as such sales involve the relations between a corporation and its *creditors* rather than intercorporate relations, they fall outside the scope of this treatise.

Private sales of railroads have, however, not been uncommon, and general statutes exist in many States authorizing the purchase by one railroad company of the road and franchises of another forming a connecting or continuous line with its own. The result to the public from such a sale and purchase in the increase of facilities for travel is the same as that following a consolidation.

§ 4. A lease executed by one corporation to another of a portion of its property, incidental to the transaction of the business for which it was organized, creates the relation of landlord and tenant between them and is governed by the general principles of law applicable to that relation. A lease by a prosperous corporation, however, of its entire property constitutes such a departure from the purposes for which it was incorporated that it requires the unanimous consent of its stockholders; and such a lease by a failing corporation can only be justified when it appears to be the best method of realizing upon the corporate assets. Principles of corporation law relating to the powers of corporations and the rights of minority stockholders may determine the validity of such leases.

The practical results of a consolidation of railroads, the increase in facilities for travel, the lowering of rates, the establishment of the through line or transcontinental system — all the results apparent from a point of view outside the corporation — may be as well obtained by a lease of corporate franchises and property for an extended period, whereby the affairs of the lessor and lessee corporations are placed under one management, as by a strict consolidation according to the provisions of a consolidation statute. The result from a point of view inside the corporation, and the relations of the corporations, are, however, essentially different. In the case of a consolidation the two companies become, as it were, partners in a new enterprise. In the case of a lease their relations are contractual and their interests as lessor and lessee are, to an extent, antagonistic.

In determining the rights of lessor and lessee under a lease of railroad property and franchises, in the usual form, the general principles of law governing the relations of landlord and tenant have little applicability. Such leases can only be executed by the sanction of the legislature. In them provisions thought essential in ordinary leases are often omitted. A lease for the usual term — nine hundred and ninety-nine years — is equivalent to a grant of the fee. "It would carry us to a time as remote in the future as the time of Alfred the Great is distant in the past."<sup>1</sup>

<sup>1</sup> Van Syckel, J., in *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 465 (1873).

§ 5. Upon the principle that a corporation may not apply its funds to objects other than those defined by its charter, it is a general rule of law that one corporation, in the absence of express statutory authority, cannot hold stock in another corporation. Such authority, however, may often be found in special charters, and appears in the general laws of the States where most of the great corporations are organized, and, under such laws, corporations have been organized for the special purpose of holding stock in other corporations.

Corporations of this nature are denominated "holding corporations," and present a late phase of corporate development. During the past ten years a large part of the practical — as distinguished from the technical — consolidations which have taken place have been effected by means of these corporations.

Where several corporations hold stock in another corporation, or where they are mutually interested in each other's shares, a "community of interest" may be said to exist. Where one corporation purchases a majority of the stock of another company, it acquires control. The control so acquired is not consolidation. Theoretically, each corporation continues a separate and distinct existence. Practically, they act together for a common purpose, and the minority stockholders in the controlled corporation too often have occasion to demand that its affairs be managed in the interests of its stockholders and not in the interest of another company.

The peculiar value of the holding corporation to the financier is that by means thereof he obtains the maximum of control at the minimum of expense. By controlling one corporation which holds control of another he may obtain practical control of the latter at but little more than half the cost of direct control.

§ 6. The union of corporate properties, as distinguished from the union of shareholders and franchises, is chiefly exemplified in the case of industrial corporations. In exceptional instances consolidation, according to statutory provisions, has been effected by such corporations. Generally, as there are no franchises to be preserved, only the uniting of corporate properties, either by direct ownership or indirectly

through controlling stock interests, has been attempted. The present method of accomplishing such result has come about through a process of evolution. At first, a simple association, without community of financial interest, was formed by corporations in the same line of business for the purpose of maintaining prices or limiting production. These associations were, as a rule, held by the courts to be unlawful combinations tending to create monopolies. To meet these objections "trusts" were created, whereby a union of interests was effected by the depositing of stock of several corporations in the hands of a trustee for a common purpose. "Trusts" in their turn were held to be unlawful combinations, as well as repugnant to elementary principles of corporation law, and finally the present method was evolved of forming a purchasing or holding corporation to acquire the property or stock of the several corporations.

The association of industrial corporations, by whatever means accomplished, has been induced by the constantly increasing tendency in modern business life toward a unification of interests and concentration of control. This tendency, while of somewhat recent inception, has developed with phenomenal and startling activity in America during the last decade. Manufacturing and mercantile corporations of great magnitude throughout the United States have been united into greater companies covering wider fields, and these, in turn, have been combined into vast aggregations of capital controlling whole branches of industry.

The principles of law governing combinations of corporations are similar to those controlling combinations of individuals. In the test of threatened injury to the public, however, the danger of a combination may lie in its corporate character. The real menace of the huge corporate combination lies in its enormous collateral and inherent power — for evil or good — which no individual or combination of individuals, as such, could ever possess. That many combinations have not worked injuriously to the interests of the public is unquestionably true; that many others, from an economic standpoint are essentially vicious, cannot be denied. All combinations should be controlled and regulated. The extent

to which they should be suppressed presents the serious problem, legal as well as economic.

The validity of a combination depends broadly upon whether it is prejudicial to the public welfare — whether it is contrary to public policy. But public policy in its very nature is uncertain and fluctuating. No definite standard can be fixed unless rules of public policy can be formulated. When a statute relating to combinations exists it is itself the rule of public policy. When no statute exists the rule must be formulated from the decisions of the courts. Were the decisions of the courts based upon a uniform course of reasoning the preparation of such a rule would merely require the classification of governing principles. But the decisions of the courts with respect to the validity of combinations have been the reverse of uniform. Courts have reached the same conclusion by widely different courses, and upon similar facts have reached widely different conclusions. Some combinations go so far in the elimination of competition that they are unlawful according to all the decisions. Others are so innocuous that their validity is generally recognized. It is with respect to the combination which is neither manifestly lawful nor unlawful that the decisions conflict. To frame a rule of public policy, therefore, is most difficult. It can only be accomplished by recognizing that any rule to have general application must furnish a conservative standard. It must rather be a test of illegality than of legality. It must be so framed that a combination contravening its provisions would in nearly all the States be held invalid.

Legislation regarding combinations has in many jurisdictions supplemented the rules of the common law. The Sherman law — the federal anti-trust statute — enacted in pursuance of the power conferred by the commerce clause of the Constitution, has proved to be a most effective instrument in dealing with combinations in restraint of interstate commerce. But the limitations of the commerce clause prevent its reaching producing combinations which do not directly restrain such commerce. Yet such combinations may operate prejudicially to the interests of States with which they have relations only by means of interstate commerce. The present federal statute reaches the

constitutional limit in the removal of restraints upon commerce. It may be necessary to proceed in the direction of imposing restraints.

The State anti-trust statutes when first enacted were sometimes so crudely drawn as to take away the property rights guaranteed by the Fourteenth Amendment, and contained exemptions which rendered them unconstitutional as class legislation. Within the last five years, however, several of the leading statutes have been before the Supreme Court of the United States. Some have been sustained and others declared unconstitutional. The States legislatures have now generally remedied the defects shown to exist in the earlier statutes by the decisions of the courts and have eliminated many of their crudities. As a whole, the present State anti-trust statutes afford remedies for many of the evils of the combination. They deal with the domestic combination and with the foreign corporation which does a localized business. But the States cannot reach the evils arising from foreign corporate combinations engaged in commerce across State lines. Whatever evils so exist can only be remedied by an appropriate federal enactment supplementing State legislation.



# PART I

## CONSOLIDATION OF CORPORATIONS

### CHAPTER I

#### NATURE OF CONSOLIDATION

- § 7. Term "Consolidation" of Uncertain Meaning.
- § 8. Uses of the Term distinguished.
- § 9. Consolidation as a Result and as a Process.
- § 10. An Analogy in the Civil Law.
- § 11. Merger.
- § 12. Amalgamation.
- § 13. Distinction between Consolidation and Sale.
- § 14. Distinction between Consolidation and Lease.
- § 15. Distinction between Consolidation and Control.
- § 16. Distinction between Consolidation and Combination.

§ 7. Term "Consolidation" of Uncertain Meaning. — The term "consolidation" as used in statutes and charters authorizing the union of several corporations has not acquired, either as a result or as a process, a recognized judicial definition.<sup>1</sup> Extended discussion of its meaning has only served to demonstrate its uncertain signification.

<sup>1</sup> In *Meyer v. Johnston*, 64 Ala. 603 (1879), it was held that the words "consolidate" and "consolidation," as used in statutes authorizing and ratifying the union or combination of several railroad corporations into one, have not acquired a recognized judicial construction, importing that all the companies are dissolved and merged into one new company; on the contrary, the terms are generally applicable to a union of two or more companies in such a way that one of them is continued in existence, though under a new name, and with enlarged powers, while the others are merged in and absorbed by it.

*Tod v. Kentucky Union Land Co.*, 57 Fed. 56 (1893): "The meaning to

be attached to the term 'consolidation' as used in a law authorizing the consolidation of two or more corporations is uncertain. It depends often upon the particular terms of the act giving the power, and the legal effect resulting from consolidation will largely depend upon the character of the consolidation authorized by the permission as well as upon the contract actually entered into by the consolidating companies. Generally the merging of the companies into a new and distinct corporation is contemplated and is the legal result. Not infrequently the absorption of one corporation by the other is the consequence of consolidation."

In *Central, etc. Co. v. Georgia*, 54

There being no definition of the word generally applicable,<sup>1</sup> its meaning, in any case, will depend upon the terms of the particular act authorizing the consolidation, and the legal result of any consolidation will be determined by the language of the statute under which the consolidation took place and by the acts and agreements of the contracting corporations relating thereto.<sup>2</sup>

Ga. 414 (1875), (reversed 92 U. S. 665 (1875)), Judge McCay, concurring, discusses the meaning of "consolidation" and distinguishes it from the English term "amalgamation."

<sup>1</sup> The following definitions of "consolidation" as applied to corporations have been given:

"The union or merger into one corporate body of two or more corporations which have been separately created for similar or connected purposes." Black's Law Dict. *sub nom.* "Consolidation of Corporations."

"Any conjunction or union of the stock, property, or franchises of two or more corporations whereby the conduct of their affairs is permanently, or for a long period of time, placed under one management." 1 Beach on Railways, § 535; 1 Beach on Corporations, § 326.

"The consolidation of corporations means, generally, the combination of two or more corporations of the same or different States, by an agreement, between them, under legislative authority, by which their rights, franchises, privileges, and property are united, and become the rights, franchises, privileges, and property of a single corporation, composed generally, although not necessarily, of the stockholders of the original corporations." 2 Clark & Marshall on Corporations, § 348.

"A consolidation of corporations is a merger, a union, or amalgamation, by which the stock of the two companies is made one, by which their property and franchises are combined into one, by which their powers be-

come the powers of one, by which the names are merged into one, and by which the identity of two practically, if not actually, runs into one." State v. Montana R. Co., 21 Mont. 242 (1898), (53 Pac. Rep. 623, 45 L. R. A. 271).

Consolidation is "a method provided by law for the formation of a copartnership between railroad corporations by which, if the expression may be used, they pool their franchises and property and are enabled to act in complete harmony under one head as a unit." Phinizy v. Augusta, etc. R. Co., 62 Fed. 684 (1894).

This comparison by Judge Simon-ton of a consolidated corporation to a partnership should, however, be considered merely as illustrating some of its features, and not, in any sense, as defining its powers. While the illustration is not inapt and is frequently used, "a company of companies" more correctly describes a consolidated corporation than a "partnership of corporations."

In Baltimore, etc. R. Co. v. Musselman, 2 Grant's Cas. (Pa.) 352 (1856), the following curious illustration of the nature of consolidation appears: "It is not a case of death, for the new corporation lives from the life of the old one: their lives are transferred into it; and unlike ordinary cases of metempsychosis this translation is accompanied by full consciousness of the former state, and its liabilities."

<sup>2</sup> Keokuk, etc. R. Co. v. Missouri, 152 U. S. 305 (1894) (14 Sup. Ct. Rep. 592).

The term "consolidation" as used in constitutional and statutory *inhibitions* is also said to have a different meaning from the same term as used in statutory authorizations.<sup>1</sup>

§ 8. **Uses of the Term Distinguished.** — The word "consolidation" is applied to various processes by which corporations may be united and to various results attained thereby:<sup>2</sup>

A. Two corporations may be combined by their fusion into a third corporation created in their stead. This results in the surrender of the vitality of the old corporations, the extinguishment of their special privileges and exemptions, and the springing into existence *eo instanti* of a new corporation with such powers and privileges as may be conferred upon it by the act authorizing the consolidation.<sup>3</sup> The dissolution of all

For full consideration of this subject see ch. VI., *post*: "*Effect of Consolidation upon Status of Consolidating Corporations and their Stockholders.*"

<sup>1</sup> See *post*, § 33: "*Construction of Prohibitions — (A) Meaning of Term 'Consolidation.'*"

<sup>2</sup> In *Railroad Co. v. Georgia*, 98 U. S. 362 (1878), Mr. Justice Strong said: "It is conceded that under this act a consolidation took place. It is therefore a vital question, What was its effect? Did the consolidated companies become a new corporation, holding its powers and privileges as such under the act of 1863? Or was the consolidation a mere alliance between two preëxisting corporations, in which each preserved its identity and distinctive existence? Or, still further, was it an absorption of one by the other, whereby the former was dissolved, while the latter continued to exist? The answer to these inquiries must be found in the intention of the legislature as expressed in the consolidation act."

<sup>3</sup> The effect of the consolidation was "the dissolution of the corporations previously existing, and at the same instant the creation of a new corporation, with property, liabilities, and stockholders derived from those

then passing out of existence." *McMahon v. Morrison*, 16 Ind. 172 (1861), approved in *Clearwater v. Meredith*, 1 Wall (U. S.) 40 (1863).

In *Railroad Co. v. Georgia*, 98 U. S. 359 (1878), the Supreme Court also said: "That generally the effect of consolidation, as distinguished from a union by one company into another, is to work the dissolution of the companies consolidating and to create a new corporation out of the elements of the former is asserted in many cases and seems to be the necessary result."

In *Vicksburg, etc. Telephone Co. v. Citizens Telephone Co.*, 79 Miss. 341 (1901) (30 So. Rep. 725, 89 Am. St. Rep. 656), the Court said: "There seems to be a great confusion as to the difference between consolidation and merger and sale. Rightly understood, there never can be a consolidation of corporations except where all the constituent companies cease to exist as separate corporations, and a new corporation, to wit, the consolidated corporation, comes into being."

See also *post*, § 60: "*As a General Rule Effect of Consolidation is Creation of New Corporation and Dissolution of Constituents.*"

the old corporations and the creation of the new one are the essential features of this process, which has been said to constitute consolidation according to the "American view."<sup>1</sup>

B. There may be an absorption of one company by another whereby the former is dissolved and passes out of existence while the latter continues to exist with enlarged powers.<sup>2</sup> The word "consolidation" has been said to be inapplicable to a union of this character,<sup>3</sup> but such use of the term is general, and is supported by the highest authorities.<sup>4</sup>

<sup>1</sup> "In the American view, therefore, it would seem that the dissolution of all the corporations and the creation of one new one are essential to consolidation." Green's *Brice's Ultra Vires* (2d ed.), 631.

<sup>2</sup> In *Central R. etc. Co. v. Georgia*, 92 U. S. 673 (1875), it was said that the consolidation there under consideration was intended to effect at most a "merger of the . . . Company with the other, a mode of transfer of that Company's franchise and property and payment therefor with stock of the Central Company."

See also *Meyer v. Johnston*, 64 Ala. 603 (1879).

<sup>3</sup> Green's *Brice's Ultra Vires* (2d ed.), 631.

*Vicksburg, etc. Telephone Co. v. Citizens Telephone Co.*, 79 Miss. 341 (1901) (30 So. Rep. 725, 89 Am. St. Rep. 656): "A merger rightly understood is not the equivalent of consolidation at all, but exists where one of the constituent companies remains in being, absorbing or merging in itself all the other constituent corporations."

*Lee v. Atlantic Coast Line R. Co.*, 150 Fed. 787 (1906): "When two or more corporations unite by way of merger the result is not the same as in case of consolidation."

<sup>4</sup> *Central University v. Waiter* (Ky. 1906), 90 S. W. Rep. 1036: "Some courts, construing somewhat similar statutes, have noticed a distinction between consolidation and merger;

the former term being used to describe the result of two corporations being combined into a new one, and the latter to describe the result where one corporation absorbs another. As corporate franchises are generally deemed unassignable without permission of the State, a merger is, after all, under our statute at least, a consolidation; for, although the old name of one may be retained and the other dropped, still the course to be pursued under the statute for one corporation to acquire the property and franchises of another is precisely the same as though a new name were adopted. The result is a merging of corporate property and constituents, as where two streams flow together. At the junction they may be said to constitute a new stream, but essentially the latter takes in and is made up of all that formerly flowed in and now flows out of the two from which it gets its being. To use another figure, it is a marriage of two, in which neither is lost, but in which the two are blended into one in contemplation of law. The original corporate existence is merely a legal status. It is not a thing at all. The power that gave it its so-called existence is competent to change it into a new being, with all the rights and attributes of the old. No physical phenomenon is involved. The legislative purpose, and the practical application of it, will not stagger in execution at an imaginary difficulty in harmonizing

C. A confederation of several corporations may be formed, in which each preserves its legal identity and distinctive existence,<sup>1</sup> as exemplified in the union of corporations of different States.<sup>2</sup> Such an alliance is sometimes called a "consolidation," but, except in the case of an interstate consolidation, it would seem that such use should be avoided if the term "consolidation" is ever to have a well-defined meaning.<sup>3</sup>

§ 9. **Consolidation as a Result and as a Process.** — Consolidation may be regarded both as a result and as a process. As a result the meaning of the term is uncertain, because it is applied to different effects produced by different means; as a process it is equally indefinite, because it is employed to describe different means for producing different results. As a result and as a process, consolidation may be broadly described, but not defined, in the following language of the Supreme Court of Alabama:

"When the rights, franchises, and effects of two or more corporations are, by legal authority and agreement of the parties, combined and united into one whole, and committed to a single

a thing dead with a thing which is alive. We are of opinion, and hold, that the effect of the consolidation was to continue in the new corporation, all the franchises, and vest in it all the property rights, subject to the terms on which it was acquired, of the two constituent corporations."

<sup>1</sup> *Railroad Co. v. Georgia*, 98 U. S. 362 (1878): "Nor was it a mere alliance or confederation of the two. If it had been each would have preserved its separate existence as well as its corporate name."

<sup>2</sup> *Post*, ch. X.: "*Interstate Consolidations*."

<sup>3</sup> An *alliance* or voluntary union between two railroad companies with respect to traffic does not amount to a consolidation. *Shrewsbury, etc. R. Co. v. Stour Valley R. Co.*, 2 De Gex, M. & G. 880 (1852), 21 Eng. Law & Eq. 628. See also *Midland Great Western R. Co. v. Leech*, 3 H. L. Cas. 872 (1852).

A *temporary coöperation* under one

management does not constitute a consolidation. *Archer v. Terre Haute R. Co.*, 102 Ill. 503 (1882) (7 Am. & Eng. R. R. Cas. 249), where the Court said: "Both corporations retained their separate existence, and it does not appear it was ever contemplated the two roads should be merged into one and both corporations pass to one management. The very terms of the agreement are inconsistent with the idea of consolidation. It follows, then, it was simply a contract for connecting the roads of the respective companies, so as to secure a continuous line between distant terminal points."

A *business arrangement* made under special statutory authority, with a view to operating by one company the road of another as a branch line, does not effect a consolidation. *Pin-gree v. Michigan Central R. Co.*, 118 Mich. 314 (1898) (76 N. W. Rep. 635, 53 L. R. A. 274).

corporation, the stockholders of which are composed of those (so far as they chose to become such) of the companies thus agreeing, this is in law and according to a common understanding, a consolidation of such companies; whether such single corporation, called a consolidated company, be a new one then created, or one of the original companies continuing in existence with only larger rights, capacities, and property."<sup>1</sup>

§ 10. **An Analogy in the Civil Law.** — The nature of consolidation may be indicated by adopting the terminology of the civil law and describing it as a process whereby the *universitas juris* of several corporations is transferred to one. This phrase expresses the legal conception of a university or bundle of rights and liabilities belonging to one person and constituting his legal personality; and when these are transferred to another he is said to take *per universitatem*, that is, he succeeds to the personality of the other and is clothed with his rights and duties.<sup>2</sup> So, by consolidation, one corporation acquires the rights and property of several and becomes responsible for their obligations. It succeeds to their legal personality, and may, appropriately, be said to take *per universitatem*.

§ 11. **Merger.** — The word "merger" is used in statutes authorizing the union of corporations to describe the process whereby the property and franchises of one or more corporations are absorbed by another which continues in existence with its

<sup>1</sup> Meyer v. Johnston, 64 Ala. 656 (1879).

In Chicago, etc. R. Co. v. Ashling, 160 Ill. 382 (1896), (43 N. E. Rep. 373), the Court quoted the above extract from Meyer v. Johnston and said: "We concur in this view as a general statement of the law, subject, however, to modification by the statutes under which the consolidation is effected."

And in State v. Montana R. Co., 21 Mont. 241 (1898), (53 Pac. Rep. 623, 45 L. R. A. 271), the Court quotes with approval the following definition of consolidation from Reese on Ultra Vires, § 142, based upon the language of Meyer v. Johnston:

"Where the rights, franchises and effects of two or more corporations are by legal authority and agreement of the parties conferred and united into one whole, and committed to a single corporation, the stockholders of which are composed of those of the companies thus agreeing, this is in law a consolidation, whether the consolidated company be a new one then created or one of the original companies continuing in existence with only larger rights, capacity and property."

<sup>2</sup> Compton v. Wabash, etc. R. Co., 45 Ohio St. 592 (1888), (16 N. E. Rep. 110).

original powers and with additional rights and privileges derived from the others.<sup>1</sup> This is a process of absorption to which, as has been noted, the term "consolidation" is generally applied, but to which the term "merger" is equally appropriate. In fact, had the word "consolidation" been used only to describe the process of fusion and the word "merger" been applied to the process of absorption, confusion would have been avoided.

§ 12. **Amalgamation.** — In England the union of several incorporated companies is generally effected under authority to "amalgamate" contained in the different Companies' Acts.<sup>2</sup> The word "amalgamation" belongs to the language of physical science, so that its use to denote the coalition of corporations is inapt. It has been stated that "nobody really knows what amalgamation means."<sup>3</sup> But it is said to take place when

<sup>1</sup> When one railroad company is merged in another the rights and privileges of the former are transferred to the latter company to be holden in the same manner and subject to the same obligations as before, except "those corporate rights and franchises of the old company which appertain to its existence and functions as a corporation. These become merged and extinct." *Tomlinson v. Branch*, 15 Wall. (U. S.) 465 (1872). And in *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 19 (1901), (21 Sup. Ct. Rep. 240), Mr. Justice Brown said: "But if, as was the case in *Tomlinson v. Branch*, one road loses its identity and is merged in another, the latter preserving its identity and issuing new stock in favor of the stockholders of the former, it is not the creation of a new corporation but an enlargement of the old one." See also *Central R., etc. Co. v. Georgia*, 92 U. S. 665 (1875).

<sup>2</sup> *Railway Clauses Act, 1863* (26 & 27 Vict., ch. 92, § 37): "For the purposes of this part of this Act, companies shall be deemed amalgamated by a special Act, in either of the following cases: (1) When by the special Act two or more companies are dis-

solved, and the members thereof respectively are united into and incorporated as a new company. (2) When by a special Act a company or companies is or are dissolved, and the undertaking or undertakings of the dissolved company or companies is or are transferred to another existing company, with or without a change in the name of that company."

<sup>3</sup> *Dougan's Case*, 28 L. T. Rep. 62 (1873), 42 L. J. Ch. 460 (on appeal, 8 Ch. App. 540): "On the general principle the case seems to me this: Two companies may be united either by fusion into a third, or by one absorbing the other. The former process seems to correspond most nearly with the popular sense of the word 'amalgamation,' and I believe nobody really knows what 'amalgamation' means."

The remarks of the English judges and the uncertain meaning of the term "amalgamation" are discussed in an article entitled "Amalgamation of Companies," 17 Sol. J. & Rep. 362: "Nearly six years have elapsed since Lord Hatherly professed himself utterly at a loss to define what the 'amalgamation' of Joint Stock Companies is. The words to which we

two or more "companies agree to abandon their respective articles of association and to register themselves under new articles as one body."<sup>1</sup> This use of the term is undoubtedly correct, but it is not applied by the English courts to such instances alone, being used synonymously with the American term "consolidation."<sup>2</sup> It has been sought to draw a distinction between them and to give the term "amalgamation" a wider meaning,<sup>3</sup> but no such distinction exists as the terms are used at the present time. A comparison of recent American and English cases will show that precisely the same results have been obtained under authority to consolidate in America as under authority to amalgamate in England.<sup>4</sup>

§ 13. **Distinction between Consolidation and Sale.** — A contract between two corporations for the purchase and sale of

refer will be found prefacing the judgment *In re Empire Assurance Corporation L. R.*, 4 Eq. 341 (1867): 'It is difficult,' said his Honour, then Vice Chancellor Wood, 'to say what the word "amalgamate" means. I confess at this moment that I have not the least conception of what the full legal effect of the word is.' Six years have elapsed and so-called 'amalgamations' we have had by the score, but from a definition of the word, or a right understanding of its meaning, we seem, if possible, further removed than ever. . . 'Nobody,' said Lord Westbury in *Blundell's Case* (17 Sol. J. & Rep. 87), 'uses it with any definite meaning,' and the word which his Lordship has suggested to replace it . . . is a 'welding.'"

See also *Wall v. London, etc. Assets Corp.* (No. 1), 67 L. J. Ch. 596 (1898), 2 Ch. 469; 79 L. T. (N.S.) 249, 47 Wkly. Rep. 219.

<sup>1</sup> *In re Bank of Hindustan*, Higg's Case, 2 Hem. & M. 666 (1865).

<sup>2</sup> *In Meyer v. Johnston*, 64 Ala. 603 (1879), the use of the term "amalgamation" in England is fully discussed.

<sup>3</sup> Green's *Brice's Ultra Vires* (2d ed.) (1880), 631, note: "The term

'amalgamation' is seldom applied to corporations in this country. That which takes its place as much as any is 'consolidation.' But though it is difficult accurately to define amalgamation as commonly used in English law, it certainly has a wider meaning than consolidation has with us. Consolidation would, *e.g.*, be inapplicable to a union of two or more companies, in such a way that one of the original corporations only was continued in existence, while the others were merged or absorbed in it. An absorption of one corporation by another would, according to some of the decisions, be an amalgamation in England; but it would not be a consolidation here." On the other hand, in the case of *Powell v. North Missouri R. Co.*, 42 Mo. 63 (1867), it was said that "an amalgamation implies such a consolidation as to reduce the companies to a common interest" and that where "by the very terms of the statute and the deed the first corporation was extinguished and the second only continued to exist" it was something more than a mere amalgamation or consolidation.

<sup>4</sup> See 1 *Beach on Railways*, § 535.



corporate property or franchises involves no coalition of interests. The vendor corporation parts with its property. The vendee corporation pays the consideration. The transfer affects in no way the *status* or continued existence of either corporation.

Consolidation, on the other hand, involves a union of corporate interests, is without consideration as between the corporate entities, and may terminate the existence of one or all of the constituent corporations. "Consolidation is not sale."<sup>1</sup>

<sup>1</sup> *Green County v. Conness*, 109 W. S. 106 (1883), (3 Sup. Ct. Rep. 69), where Mr. Chief Justice Waite said: "If only a sale of the road to another company had been authorized and made, then it might very plausibly have been contended that the purchasing company took and held it under its own charter only, without the franchises and privileges connected with it in the hands of the vendor company; but 'consolidation' is not sale, and when two companies are authorized to consolidate their roads, it is to be presumed that the franchises and privileges of each continue to exist in respect to the several roads so consolidated."

*In re Bank of Hindustan, Higg's Case*, 2 Hem. & M. 666 (1865): "Take the assets and liabilities — that I can understand; but that is not any such amalgamation as Mr. Jessel suggests, but is simply a sale of its business by one company to the other. . . . The actual contract in this case was a simple sale of the business of one company to the other, and not an amalgamation in any sense."

*Gulf, etc. R. Co. v. Newell*, 73 Tex. 334 (1889), (11 S. W. Rep. 342, 15 Am. St. Rep. 788): "A railway company by buying the stock of another and by buying the corporate franchise and property of the other, it having the power to buy, only becomes the

owner of such franchise and property. Ownership alone does not operate a consolidation of that bought with the purchaser. . . . While an execution sale of the franchise and property of a railway company conveys the franchise and property to the purchaser, still the corporate existence of the sold-out company remains."

*Hiles v. Hiles Co.*, 120 Ill. App. 617 (1905): "Where one corporation sells to another its tangible property, including its good will, retaining its franchise, its stockholders, and a considerable amount of assets and receiving the consideration arising as a result of the transaction, a sale and not a consolidation is effected." See also *Sartison v. Baltimore, etc. R. Co.*, 103 Ill. App. 507 (1902).

*Overstreet v. Citizens Bank*, 12 Okl. 383 (1903), (72 Pac. Rep. 383): "One corporation may, in contemplation of closing up its business, sell its assets, property, and business to another corporation, and make arrangements for the liquidation of its liabilities, but this does not constitute a consolidation." See also *Chase v. Michigan Telephone Co.*, 121 Mich. 631 (1899), (80 N. W. Rep. 717); *Capital Traction Co. v. Offut*, 17 App. D. C. 292 (1900); *Mackintosh v. Flint, etc. R. Co.*, 34 Fed. 582 (1888); *State v. Sherman*, 22 Ohio St. 428 (1872); *Houston, etc. R. Co. v. Shirley*, 54 Tex. 125 (1880); *Rafferty*

In *Compton v. Wabash, etc. R. Co.*<sup>1</sup> the Supreme Court of Ohio said: "Whilst the transaction has some of the features, it is wanting in the essential elements, of a sale. A sale implies a vendor and a vendee, and by it the former sells and transfers a thing that he owns to the latter for a price paid or to be paid to himself. The vendor parts with nothing but his property, and for it receives a *quid pro quo*. Such is not the case where companies are consolidated under this statute. It is true that the owner of each constituent road parts with its property. But it does much more; it not only parts with

*v. Buffalo City Gas Co.*, 37 App. Div. (N. Y.) 618 (1899), (56 N. Y. Supp. 288).

*Compare Chicago, etc. R. Co. v. Ashling*, 160 Ill. 373 (1896), (43 N. E. Rep. 373), where it was held that a consolidation and not a sale was effected by the transfer of all the stock, property and franchises of one corporation to another in exchange for its stock issued to the stockholders of the former corporation.

*Chicago, etc. R. Co. v. Ferguson*, 106 Ill. App. 358 (1903): "A consolidation, not a purchase, is effected by the transfer of the franchise and all the property of one corporation to another, under an arrangement by which the stockholders of the former company exchange their stock for stock in the latter company."

In *Shadford v. Detroit, etc. R. Co.*, 130 Mich. 300 (1902), (89 N. W. Rep. 960), it was held that a transaction by which a street railway company absorbed the business and property of other similar companies through the issue of its stocks and bonds in exchange for the stocks and bonds of the other companies and without any consideration passing to such companies was a consolidation and not a sale, and that the absorbing company was liable for the debts of the companies absorbed. The Court said: "We are of the opinion that each transaction was a consolidation in fact, or as it is termed in England an 'amalgamation.'"

The law will not permit the creditors of two corporations to be deprived of the assets of such corporations in payment of their debts and turn them over to suits in equity against the stockholders where the union or consolidation with another corporation is effected without the passage of a dollar or other valuable consideration passing between the corporations themselves. The effect is precisely the same as though the stockholders of the . . . [two companies] . . . had united to form the electric company and had pooled their stock and bonds into the new company."

See also *Howell v. Lansing, etc. Traction Co.*, 146 Mich. 450 (1906), (109 N. W. Rep. 846). Also *Appeal of Fame Hose Co.*, 6 Leg. Gaz. (Pa.) 79 (1874).

The transactions stated in the Michigan cases seem clearly to have been *sales* — or more properly exchanges — in which the consideration — the stocks and bonds — was distributed directly to the stockholders and bondholders of the vendee corporation and which were fraudulent and void as to creditors. (*Post*, § 124, "*Fraudulent Sales*.") There being no statutory authority for consolidation, the absorbing corporation was not even a *de facto* consolidated corporation.

<sup>1</sup> *Compton v. Wabash, etc. R. Co.*, 45 Ohio St. 615 (1888), (16 N. E. Rep. 110).

its property, but ceases to be a juristical entity, capable of owning or acquiring property. It does not, and could not, receive any consideration for the transfer, because it is extinguished and dissolved by the act of its stockholders in assenting to the proposed agreement. It is futile to attempt to urge that the consideration is received by the stockholders. They are not the corporation, nor do they represent it in its relation to its creditors."

§ 14. **Distinction between Consolidation and Lease.** — The same distinction may be drawn between a lease of corporate property and franchises and a consolidation of corporations as between a sale and consolidation.

In the case of a lease the interests of the corporations as lessor and lessee are, to an extent, antagonistic, and the lessor company parts with the control of its property, and, for the term, receives a rental in lieu thereof. Consolidation, on the other hand, by whatever means accomplished, results in a *union* of corporate interests and stockholders,<sup>1</sup> and the stockholders of consolidating companies, through their acquisition of shares in the new corporation, still retain, to a certain extent, control of their original corporate property. "Power to consolidate," said the Supreme Court of New Jersey in *Mills v. Central R. Co.*,<sup>2</sup> is power to take in a partner or go

<sup>1</sup> "The distinguishing feature of a consolidation is the union of the shareholders of the two companies thereby forming one company." 2 Morawetz on Priv. Corp., § 939, note 2, citing *Houston, etc. R. Co. v. Shirley*, 54 Tex. 125 (1880).

In *State v. Montana R. Co.*, 21 Mont. 243 (1898), (53 Pac. Rep. 623, 45 L. R. A. 271), it was said: "Lease does not imply consolidation; nor consolidation, lease. The power to consolidate, as we have seen, is a power to make two corporations one; the power to lease carries with it no power to pass anything except the right to use the property leased. In the lease under consideration there is no merger of ownership, no communion of interest, no distribution

of receipts based upon a contingent measure of profit, no common ownership of shares of stock, no joint management, and no yielding up of an independent corporate existence by the lessor to the lessee."

<sup>2</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 7 (1886), (2 Atl. Rep. 453).

In *State v. Vanderbilt*, 37 Ohio St. 638 (1882), the distinction between a lease and consolidation is presented from a different point of view: "By force of such lease, the right to the use of the road passed from the lessor to the lessee, according to such terms and conditions with respect to the use as are proper in a lease; but nothing else passed. The lessee is the assignee for a term or period of the lessor, — his bailee to hold possession for him.

in as a partner, while power to lease is power to dispose of the whole concern to a stranger."

§ 15. **Distinction between Consolidation and Control.** — While one corporation by purchasing a majority of the shares of another company may obtain control of the latter, the result is radically different from a consolidation.<sup>1</sup> In consolidation there is a union of corporate interests and stockholders. In the case of the acquisition of stock the purchasing corporation becomes merely a stockholder and the rights of the corporations, as such, remain unchanged. Control is not consolidation; it is not, strictly speaking, even a conjunction of corporate properties. As said by Mr. Chief Justice Waite in *Pullman Car Co. v. Missouri Pacific R. Co.*,<sup>2</sup> in reference to a stockholding corporation: "Its rights and its powers are those of a stockholder only. It is not the corporation, in the sense of that term as applied to the management

The power to lease does not imply a power to consolidate, nor does the power to consolidate imply a power to lease, but these powers are distinct and independent."

See also *Commissioners v. Lafayette*, etc. R. Co., 50 Ind. 110 (1875); *Gere v. New York Central R. Co.*, 19 Abb. N. C. 210 (1885); *Archer v. Terre Haute*, etc. R. Co., 102 Ill. 493 (1882).

Upon the principle that constitutional prohibitions against the consolidation of competing railroads must be liberally construed for the preservation of competition, it has been held that a lease of a competing railroad comes within such a prohibition. *State v. Atchison*, etc. R. Co., 24 Neb. 143 (1888), (38 N. W. Rep. 43; 8 Am. St. Rep. 164 n.), S.C. 38 Neb. 437 (1893), (57 N. W. 20). *East St. Louis*, etc. R. Co. v. *Jarvis*, 92 Fed. 743 (1899). The correctness of this construction is considered in another section. See *post*, § 34: "*Construction of Prohibitions — (B) Whether a Lease amounts to Consolidation.*"

<sup>1</sup> The mere fact that one corporation has obtained control of the stock

in another corporation is not, of itself, sufficient to show a consolidation of the two corporations. *Jessup v. Illinois Cent. R. Co.*, 36 Fed. 735 (1888).

In *Chase v. Michigan Telephone Co.*, 121 Mich. 634 (1899), (80 N. W. Rep. 717), the Court said: "Although one person owns a majority of the stock or all but two shares, or all of it, he does not thereby acquire the right of acting for the corporation, or as the corporation, independently of the directors, . . . Nor is that fact evidence of merger."

In *Tod v. Kentucky Union Land Co.*, 57 Fed. 58 (1893), (reversed *sub nom.* *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335 (1894)), the acquisition of substantially all the stock of one corporation by another was held, under the circumstances there shown, to amount to a "temporary consolidation."

<sup>2</sup> *Pullman Car Co. v. Missouri Pac. R. Co.*, 115 U. S. 597 (1885), (6 Sup. Ct. Rep. 194). Compare *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368. See also *post*, § 294: "*Meaning of term 'Control.'*"

of the corporate business or the control of the corporate property.”<sup>1</sup>

§ 16. **Distinction between Consolidation and Combination.** — Combination is coöperation and, broadly speaking, a consolidated corporation illustrates the extreme development of the idea of coöperation with reference to corporations. In this treatise, however, — following the common usage, — the term “combination” is used to describe any union of corporations entered into by mutual agreement for supposed mutual advantage, *not amounting to consolidation*.<sup>2</sup>

The distinction may be sharply drawn. The validity of a consolidation depends upon the existence of statutory authority therefor. Questions of public policy regarding consolidation are not material. Unless authorized by statute a consolidated corporation cannot be created; if authorized it is not against public policy, for that which the statute permits *cannot* be against public policy.

The validity of a combination, on the other hand, generally depends upon considerations of public policy. Statutes seldom authorize, but often prohibit, the combination of corporations.<sup>3</sup>

<sup>1</sup> For consideration of question whether control of several corporations by another amounts to an unlawful combination, see *post*, § 397: “*Form of Combination Immaterial. — Illegality of Corporate Device.*”

<sup>2</sup> See *post*, Part V, “*Combinations of Corporations.*”

<sup>3</sup> *Distinction between consolidation and reorganization.*

Sales, leases and combinations, while readily distinguishable from consolidations, nevertheless involve intercorporate relations. In the case of a reorganization, however, there is no connection of any nature between different corporations. Reorganization is the readjustment of the affairs

of individual corporations — “the carrying out by proper agreements and legal proceedings of a business plan or scheme for winding up the affairs of, or foreclosing a mortgage or mortgages upon, the property of insolvent corporations, more frequently railroad companies. It is usually by the judicial sale of the corporate property and franchises, and the formation by the purchasers of a new corporation, in which the property and franchises are thereupon vested, and the stocks and bonds of which are divided among such of the parties interested in the old company as are parties to the reorganization plan.” Bouvier’s Law Dict.

## CHAPTER II

## LEGISLATIVE AUTHORITY FOR CONSOLIDATION

I. *Necessity for Legislative Authority*

- § 17. Consolidation without Legislative Authority *ultra vires*.
- § 18. Consolidation of *Quasi-public* Corporations without Legislative Authority against Public Policy.

II. *Conferring and Withdrawal of Legislative Authority*

- § 19. Power of Legislature to authorize Consolidation.
- § 19 a. Authorization of Consolidation of Interstate Railroads not regulation of Interstate Commerce.
- § 20. Legislative Sanction — How expressed.
- § 21. Public Policy regarding Consolidation of Non-competing Railroads.
- § 22. What Railroads may consolidate — Statutory Provisions.
- § 23. What Corporations other than Railroads may consolidate — Statutory Provisions.
- § 24. Power of Legislature to withdraw or limit Right to consolidate — (A) In Absence of Reserved Power.
- § 25. Power of Legislature to withdraw or limit Right to consolidate — (B) In Exercise of Reserved Power.
- § 26. Power of Legislature to withdraw or limit Right to consolidate — (C) In Exercise of Police Power.

III. *Construction of Statutes authorizing Consolidation*

- § 27. General Rules of Construction.
- § 28. Construction of Particular Statutory Provisions.
- § 29. Construction of Statutes authorizing Consolidation of Railroads — Connecting or Continuous Lines.
- § 30. Construction of Statutes authorizing Consolidation of Corporations other than Railroads.

I. *Necessity for Legislative Authority*

§ 17. **Consolidation without Legislative Authority *ultra vires*.**  
 — The charter of a corporation, read in connection with the general laws applicable to it, is the measure of its powers. The enumeration therein of the powers conferred implies the exclusion of other powers, and a corporation can exercise no authority not granted to it, expressly or by necessary implication, in its charter or other legislative act.<sup>1</sup>

<sup>1</sup> Central Transp. Co. v. Pullman Car Co., 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478).

"A charter being a contract giving a corporation all the powers which it can exercise, any alteration which the

There is also said to be an implied contract, as well between the corporation and the State as between the corporation and its stockholders, that its corporate property and franchises shall only be appropriated to uses authorized by its charter, and any acts of the corporation outside the limits so prescribed are *ultra vires*.<sup>1</sup> Consolidation necessitates the embarkation of corporate properties upon a new undertaking — a joint adventure instead of an individual enterprise — and is *ultra vires* unless authorized by legislative authority.<sup>2</sup>

In so far, also, as consolidation involves the creation of a

corporation desires to make therein must in the first place have the sanction of the legislature.' Green's Brice's *Ultra Vires* (2d ed.), 632.

<sup>1</sup> *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 465 (1873); *Abbott v. Johnston, etc. Horse R. Co.*, 80 N. Y. 27 (1880), (36 Am. Rep. 572).

<sup>2</sup> In *Pearce v. Madison, etc. R. Co.*, 21 How. (U. S.) 442 (1858), Mr. Justice Campbell said: "The rights, duties, and obligations of the defendants are defined by the acts of the Legislature of Indiana under which they were organized, and reference must be had to these to ascertain the validity of their contracts. They empower the defendants respectively to do all that was necessary to construct and put in operation a railroad between the cities which are named in the acts of incorporation. There was no authority of law to consolidate these corporations and to place both under the same management, or to subject the capital of the one to answer for the liabilities of the other."

See also *New York, etc. Canal Co. v. Fulton Bank*, 7 Wend. (N. Y.) 412 (1831); *Blatchford v. Ross*, 54 Barb. (N. Y.) 42 (1869); *Greenville Compress, etc. Co. v. Planters' Compress, etc. Co.*, 70 Miss. 669 (1893), (13 So. Rep. 879; 35 Am. St. Rep. 681); *Kavanaugh v. Omaha Life Assn.*, 84 Fed. 295 (1897); *Home Friendly Soc. v. Tyler* (Com. Pl.), 9 Pa. Co. Ct. Rep.

617 (1891). *Overstreet v. Citizens Bank*, 12 Okl. 383 (1903), (72 Pac. Rep. 379); *Jones v. Missouri Edison Electric Co.*, 135 Fed. 153 (1905), (*reversed* on other points 144 Fed. 775 (1906)), *Re Era Ins. Soc.*, 30 Law J. Eq. (N.S.) 137 (1860), (6 Jur. (N.S.) 1334, 9 Wkly. Rep. 67). In *Clinch v. Financial Corp.*, L. R. 4 Ch. App. 117 (1868), it was held that an arrangement for amalgamation by which liabilities were imposed on the stockholders was void as *ultra vires* and *semble* that such an arrangement would be void, even if only the shareholders who assented to it were bound by it.

Many of the railroad cases cited in note to § 18 *post*, while illustrating the principle that franchises may not be transferred without legislative sanction upon grounds of public policy, also support the principle stated in the text, applicable to *all* corporations, that an unauthorized consolidation is *ultra vires*.

Religious corporations have no common law right to consolidate, although they may do so under a consolidation statute broad enough to cover them. A single member of the corporation may maintain an action to set aside such an agreement as *ultra vires*. And the *ultra vires* act cannot be defended upon the ground that it is advantageous.

*Davis v. Cong. Beth Tephilas Israel*, 57 N. Y. Supp. 1015 (1899).

new corporation, legislative authority is as essential as it is to the creation of a corporation in the first instance. An attempt at the organization of a consolidated corporation in the absence of a statutory provision for consolidation does not even create a corporation *de facto*, since corporations *de facto* can only exist when there is a law under which they may be incorporated.<sup>1</sup>

§ 18. **Consolidation of Quasi-public Corporations without Legislative Authority against Public Policy.** — There is another principle, in addition to that of *ultra vires*, why a railroad company or other *quasi*-public corporation<sup>2</sup> cannot transfer its franchises to another corporation, through the process of consolidation, without the sanction of the legislature which granted them. That principle is, that where such a corporation has had granted to it by its charter franchises and privileges to enable it to provide facilities for the benefit of the public, it assumes the due performance of those functions as the consideration of the grant, and any contract or arrangement which disables it from performing them — which undertakes, without the consent of the State, to transfer to others the rights and powers conferred by the charter and to relieve the grantee of the burden imposed — is a violation of the contract with the State and against public policy.<sup>3</sup> An at-

<sup>1</sup> American Loan, etc. Co. v. Minnesota, etc. R. Co., 157 Ill. 641 (1895), (42 N. E. Rep. 153). See "*Irregular and Invalid Consolidations*," ch. IX, *post*.

<sup>2</sup> It is generally held that a railroad company is a *quasi*-public corporation. The State grants it extraordinary powers — the right to condemn lands and take tolls for the public benefit. In accepting its charter it assumes obligations to the State and to the public, and to that extent is a public corporation. (Peoria, etc. R. Co. v. Coal Valley Mining Co., 68 Ill. 489 (1873)). On the other hand the stockholders furnish the means for the construction and equipment of the railroad, and are entitled to the profits derived from its operation. To this extent, a railroad company is a private

corporation. Being thus at once a public corporation existing for private gain and a private corporation owing public duties, a railroad company is called, with propriety, a *quasi*-public corporation. See United States v. Trans-Missouri Freight Ass'n., 166 U. S. 321 (1897), (17 Sup. Ct. Rep. 540); Black v. Delaware, etc. Canal Co., 24 N. J. Eq. 469 (1873); Chicago, etc. R. Co. v. Wabash, etc. R. Co., 61 Fed. 997 (1894). In Pierce v. Commonwealth, 104 Pa. St. 155 (1883), however, it was denied that a railroad company is a *quasi*-public corporation, and it was said to be "a private corporation and nothing more."

<sup>3</sup> Thomas v. Railroad Co., 101 U. S. 71 (1879).



tempted consolidation, therefore, without legislative sanction, is opposed to public policy and void.<sup>1</sup>

An unauthorized consolidation of corporations owing public duties is also invalid as involving a delegation of corporate powers.<sup>2</sup>

## II. *Conferring and Withdrawal of Legislative Authority*

§ 19. **Power of Legislature to authorize Consolidation.** — So far as the public rights are concerned, the power of the legislature to authorize a consolidation of corporations is, in the absence of special constitutional restrictions, unquestioned.<sup>3</sup> The State has the same power to authorize several existing corporations to associate together and organize themselves into a new corporation as it has to incorporate individuals.<sup>4</sup> It has been held, however, that corporations are not such "persons" as may themselves form corporations.<sup>5</sup>

As a consolidated corporation becomes a new and distinct

<sup>1</sup> *United States*: *Clearwater v. Meredith*, 1 Wall. 39 (1863); *Shields v. Ohio*, 95 U. S. 322 (1877); *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 677 (1896), (16 Sup. Ct. Rep. 714).

*Illinois*: *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153).

*Indiana*: *State v. Bailey*, 16 Ind. 46 (1861), (79 Am. Dec. 405); *Shelbyville, etc. Turnpike Co. v. Barnes*, 42 Ind. 498 (1873); *State v. Beck*, 81 Ind. 500 (1882); *Crawfordsville, etc. Turnpike Co. v. State*, 102 Ind. 435 (1885), (1 N. E. Rep. 864).

*Mississippi*: *Adams v. Yazoo, etc. R. Co.*, 77 Miss. 194 (1899), (24 So. Rep. 200, 60 L. R. A. 33n); *affirmed*, 180 U. S. 1 (1901), (21 Sup. Ct. Rep. 240).

*New Jersey*: *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 455 (1873); *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453).

*Pennsylvania*: *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42 (1858), (72 Am. Dec. 685).

*Texas*: *East Line, etc. R. Co. v.*

*State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690); *Gulf, etc. R. Co. v. Newell*, 73 Tex. 334 (1889), (11 S. W. Rep. 342; 15 Am. St. Rep. 788); *Missouri Pac. R. Co. v. Owens*, 1 White & W. Civil Cas. Ct. App. § 385 (1883).

*England*: *Charlton v. Newcastel, etc. R. Co.*, 5 Jur. (N. s.) 1096 (1859).

The principle that the franchises of quasi-public corporations cannot be transferred by the process of consolidation applies equally to any form of transfer — sale or lease — and is supported by cases referring to any form (see *post*, ch. XII, XVI. An attempt has been made, however, to classify the cases under their distinctively appropriate heads.

<sup>2</sup> See *post*, ch. XII: "*Sales of Corporate Franchises.*"

<sup>3</sup> *Clearwater v. Meredith*, 1 Wall. (U. S.) 39 (1863); *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 455 (1873).

<sup>4</sup> *State Treasurer v. Auditor General*, 46 Mich. 233 (1884), (9 N. W. Rep. 258).

<sup>5</sup> *Factors, etc. Ins. Co. v. New Harbor Protection Co.*, 37 La. Ann. 233 (1885). See also *post*, § 266.

corporation, a special statute authorizing consolidation contravenes a constitutional provision against the creation of corporations by special act.<sup>1</sup> For the same reason a consolidated corporation may be organized for the full statutory period irrespective of the terms of existence of the constituent corporations, and it cannot be objected that the consolidation in effect extends the existence of such corporations beyond the period fixed by law.<sup>2</sup>

The existence of an outstanding contract between a constituent corporation and an individual does not prevent the legislature from authorizing a consolidation upon the ground that the obligation of such contract would be impaired, where the act of consolidation provides that the consolidated com-

<sup>1</sup> *Shields v. Ohio*, 95 U. S. 323 (1877): "If the argument of the learned counsel for the plaintiff in error be correct, the constitutional restrictions can be readily evaded. Laws may be passed at any time, enacting that all the valuable franchises of designated corporations antedating the Constitution shall, upon their dissolution, voluntary or otherwise, pass to and vest in certain newly created institutions of the like kind. The claim of the inviolability of such franchises should rest on the same foundation as the affirmation in the present case. The language is broad and clear, and forbids a construction which would permit such a result."

A statute entitled "An act in relation to gas companies" and authorizing the consolidation of such companies in a certain city is not invalid because the title does not refer to the particular subject of consolidation, that being germane to its general subject. Nor is such a statute unconstitutional as granting a corporation special privileges and franchises — it applying to all companies organized or to be organized in the particular territory. Nor is it in violation of a constitutional provision

that the charter of no corporation shall be amended or changed except by a general law — the consolidated corporation taking only the powers and privileges of its constituents.

*People v. People's Gas Light Co.* 205 Ill. 482 (1903), (68 N. E. Rep. 950, 98 Am. St. Rep. 244).

The Court said in this case regarding the point last stated: "Although the general rule is that the consolidation of several corporations into a new one invests the latter with all the rights and privileges of the several constituent companies, such is not the result of consolidation or merger under this statute."

<sup>2</sup> The consolidated corporation becomes a new and distinct corporation which may be organized for the term of fifty years, irrespective of the term of existence of the constituent corporations, and it cannot be objected to the consolidation that it has the effect to extend the existence of the constituent corporations beyond the period of fifty years fixed for each of them. *Market St. R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225). See also *New York Central etc. R. Co. v. City of Yonkers*, 103 N. Y. Supp. 252 (1907).

pany shall assume and discharge the liabilities of the constituent corporations. In such a case it was said by the Supreme Court of the United States that "proper care was taken by the legislature to protect the rights of these complainants by incorporating into the act uniting the two colleges a provision that the new corporation should discharge and perform those liabilities without diminution or abatement. Such contracts were made with the trustees, and not with the State, and it is a mistake to suppose that the existence of such a contract between the corporation and an individual would inhibit the legislature from altering, modifying, or amending the charter of the corporation by virtue of a right reserved to that effect, or with the assent of the corporation, if in view of all the circumstances the legislature should see fit to exercise that power."<sup>1</sup> In a still earlier case it was intimated by the same Court that a consolidation might be authorized without special provision being made for the creditors of the constituent companies.<sup>2</sup>

§ 19 a. **Authorization of Consolidation of Interstate Railroads not Regulation of Interstate Commerce.** — The fact that a railroad company engages in interstate commerce does not affect its *status* as a State corporation. Its one source of corporate power is the State which created it. Authority for its consolidation with domestic or foreign railroad corporations can be obtained from the State alone. While Congress might prevent, it could not authorize such a consolidation.<sup>3</sup> State

<sup>1</sup> Pennsylvania College Cases, 13 Wall. (U. S.) 222 (1871).

<sup>2</sup> Smith v. Chesapeake, etc. Canal Co. 14 Pet. (U. S.) 48 (1840): "There can be no doubt that the States of Virginia and Maryland in granting the charter of the Chesapeake and Ohio Canal Company had the power to authorize a surrender of the charter of the Potomac Company, with the consent of the stockholders; and to make the provision which they did make for the creditors of the company. This assignment does not impair the obligation of the contract of any creditor of the company, nor place

him in a worse position in regard to his demand. The means of payment possessed by the old company are carefully preserved and, indeed, guaranteed by the new corporation. And if the fact can be established, which is denied by the defendants, that some *bona fide* creditors of the Potomac Company were unprovided for in the new charter, and consequently have no redress against the defendant, it does not follow that they are without remedy."

<sup>3</sup> The *authorization* of consolidation and its *prohibition* stand upon essentially different grounds. In the one

consolidation statutes although applying to interstate railroads are not regulations of interstate commerce in violation of the federal Constitution. They relate rather to the instrumentalities of commerce than to commerce itself.

In *Louisville, etc. R. Co. v. Kentucky*,<sup>1</sup> the Supreme Court of the United States said: "It has never been supposed that the dominant power of Congress over interstate commerce took from the States the power of legislation with respect to the instruments of such commerce, so far as the legislation was within its ordinary police powers. Nearly all the railways in the country have been constructed under State authority, and it cannot be supposed that they intended to abandon their power over them as soon as they were finished. The power to construct them involves necessarily the power to impose such regulations upon their operation as a sound regard for the interests of the public may seem desirable. In the division of authority with respect to interstate railways Congress reserves to itself the superior right to control their commerce and forbid interference therewith; while to the States remains the power to create and to regulate the instruments of such commerce, so far as necessary to the conservation of the public interests."<sup>2</sup>

While the States alone can authorize State corporations to consolidate it does not follow from the decision in the *Louisville* case that they have exclusive power over corporations as instruments of interstate commerce. Congress, undoubtedly, has power to provide that interstate railroads shall be operated solely by federal corporations. Such an enactment while leaving in the State full authority over its corporations would take away their character as instruments of interstate commerce. The power of the State to authorize the consolidation of the

case the powers of a State corporation are extended; in the other, interstate commerce is kept free from the effects of combination. See *post*, § 38, "*Prohibition of Consolidation of Competing Railroads not Regulation of Interstate Commerce.*"

<sup>1</sup> *Louisville etc. R. Co. v. Kentucky*, 161 U. S. 677, 702 (1895), (16 Sup. Ct. Rep. 714).

<sup>2</sup> The fee required for filing certificates of the consolidation of interstate railroad corporations is not a tax upon the right to engage in interstate commerce, but upon the right to incorporate.

*Chicago, etc. R. Co. v. State*, 153 Ind. 134 (1899), (51 N. E. Rep. 924).

corporations would remain but they could not operate interstate railroads. But in absence of adverse federal legislation both the powers of the State corporation and of the State itself are unaffected.<sup>1</sup>

§ 20. **Legislative Sanction — How expressed.** — Legislative approval of consolidation may be expressed in various ways. A grant of power to consolidate contained in the charters of the constituent corporations or in general laws passed prior to their incorporation furnishes undoubted authority.<sup>2</sup> Acts passed subsequent to the incorporation of the companies but prior to their consolidation are, subject to constitutional objections to be hereafter noticed,<sup>3</sup> sufficient.<sup>4</sup>

It is not essential that authority should be granted before consolidation. The legislature can validate after the fact that which it may authorize in the first instance, and a subsequent act ratifying an informal consolidation has the same effect as

<sup>1</sup> In *Boardman v. Lake Shore, etc. R. Co.*, 84 N. Y. 185 (1881) State legislation authorizing the consolidation of railroad corporations of adjoining States was held not to be a regulation of interstate commerce in violation of the commerce clause. The ground upon which the decision was placed was that, in the absence of action by Congress, the States have power to enact such legislation — that not the power in Congress, but its exercise, is inconsistent with the exercise of the same power by the State legislatures.

The Court said: "There is, we think, no force in the position that the acts of the legislatures of the several States through which the railroads run, so far as they relate to or authorize the consolidation in the adjoining States are in violation of subdivision 3 of section 8 of the first article of the Constitution of the United States which confers upon Congress the power to regulate commerce with foreign nations and with the several States. It is not claimed that Congress has legislated in respect to the subject, or

assumed to exercise the power conferred by the Constitution, and it has not yet been decided that the provision cited requires that the power conferred should be exercised by Congress alone and is taken away entirely from the control of the State legislatures. The conclusion, therefore, is inevitable that in the absence of such legislation by Congress the power exists in the State to legislate upon the subject."

This language can only be justified upon the broad ground stated in the text that Congress having the paramount power over the whole subject of interstate railroads may create its own instrumentalities and thereby deprive State statutes of effective force. It cannot be justified upon the ground that Congress has the superior right — or any right whatever — to authorize the consolidation of State corporations.

<sup>2</sup> *Fisher v. Evansville, etc. R. Co.*, 7 Ind. 407 (1856).

<sup>3</sup> *Post*, § 43.

<sup>4</sup> *Sparrow v. Evansville, etc. R. Co.*, 7 Ind. 369 (1856).

a prior grant of power.<sup>1</sup> Express ratification is not necessary. Recognition by the legislature of the consolidated corporation cures any defect arising from the want of legislative authority to consolidate.<sup>2</sup> Legislative recognition amounts to legislative ratification. General statutes authorizing the consolidation of corporations are, however, not retroactive and do not apply to consolidation agreements made prior to their enactment.<sup>3</sup>

§ 21. **Public Policy regarding Consolidation of Non-competing Railroads.** — Although authority to amalgamate has been granted, by special act, to railroad companies in England, it may be said that the public policy of that nation, as manifested by acts of Parliament and by the appointment of parliamentary committees to investigate the subject, is opposed to the consolidation of such companies.<sup>4</sup>

In America, however, the public policy of nearly all the States, as indicated by the enactment of general consolidation acts, is in favor of the consolidation of non-competing

<sup>1</sup> *Mitchell v. Deeds*, 49 Ill. 416 (1867), (95 Am. Dec. 621): "The legislature has the same power to ratify and confirm an irregularly organized corporate body that they have to create a new one. And by the act confirming the consolidation before then entered into, the corporate body which was organized in accordance with the act of consolidation, became legal, notwithstanding such organization may have been irregular."

See also *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595). *Bishop v. Brainerd*, 28 Conn. 289 (1859).

<sup>2</sup> The passage of a legislative act whereby the existence of a consolidated corporation is expressly recognized is a ratification of and legalizes the consolidation. *Louisville Trust Co. v. Louisville, etc. R. Co.*, 75 Fed. 433 (1896). See also *United States v. Southern Pac. Co.*, 45 Fed. 596 (1891); *Mead v. New York, etc. R. Co.*, 45 Conn. 199 (1877); *Atlantic,*

*etc. R. Co. v. St. Louis*, 66 Mo. 228 (1877); *McCauley v. Columbus, etc. R. Co.*, 83 Ill. 352 (1876).

<sup>3</sup> *Hatcher v. Toledo, etc. R. Co.*, 62 Ill. 480 (1872): "The law is not retrospective in terms and cannot be made so by any fair construction. . . . It is manifest that this act was intended to apply to companies which might effect a consolidation after its passage."

<sup>4</sup> One ground of objection is indicated in *East Anglian R. Co. v. Eastern Counties R. Co.*, 11 Com. B. 812 (1851): "The public also has an interest in the proper administration of the powers conferred by the act. The comfort and safety of the line may be seriously impaired if the money supposed to be necessary and destined by Parliament for the maintenance of the railway, be expended in other undertakings not contemplated when the act was obtained and not expressly sanctioned by the legislature."

railroad corporations. The Court of Appeals of New York has said that "whatever may be the rule in other States or in England, the public policy of this State, as manifested by numerous acts of the legislature, has always been not only to afford the fullest scope for the consolidation and reorganization of non-competing railroads and railroad corporations, but also for the transfer of the use of such roads and their franchises by one corporation to another."<sup>1</sup> It has, also, been said in regard to the Illinois statutes authorizing consolidation and their construction by the courts of that State that "great encouragement has been given to the union of lines of railroad for the purpose of having them operated under some general management, the result of which has been the consolidation of many lines of road which were originally separate and distinct, but which are now operated under a uniform system."<sup>2</sup>

The public policy of Illinois has, however, been *adverse* to the consolidation of domestic railroad companies with those of other States.<sup>3</sup>

§ 22. **What Railroads may consolidate — Statutory Provisions.** — Nearly all the States have general railroad consolidation statutes, of which an abstract is printed in the subjoined note.<sup>4</sup>

<sup>1</sup> *Woodruff v. Erie R. Co.*, 93 N. Y. 615 (1883).

<sup>2</sup> *Dimpfel v. Ohio, etc. R. Co.*, 9 Biss. (U. S.) 127 (1879), (8 Rep. 641, 7 Fed. Cas. 722).

<sup>3</sup> In *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153), the Supreme Court of Illinois said: "This legislation taken in connection with the specific repeal of the act of 1854 seems to indicate a legislative public policy adverse to the consolidation of railroad companies organized under the laws of this State with railroad companies formed in other States. And the same general policy seems to be denoted by the proviso to the act approved March 30, 1875. . . . The proviso is, that nothing in that

act shall be so construed as to authorize any corporation acting by or organized under the laws of any other State to purchase or otherwise become the owner of any railroad in this State."

<sup>4</sup> *Alabama*. Civil Code 1896, ch. 28, § 1166 (as amended by acts 1900-01, p. 237): "Whenever the lines of any two or more railroads, or contemplated railroads, chartered under the laws of this or any other State which, when completed, may admit passage of cars over any two or more of such roads continuously without break or interruption," such companies may consolidate.

*Arizona*. Rev. Stat. 1901, par. 864: Railroad corporations shall have power "to consolidate with one or

These statutes, as a general rule, provide only for the consolidation of corporations owning connecting or continuous

more corporations formed under this title, or under the laws of any other State or Territory."

*Arkansas.* Kirby's Dig. 1904, § 6735: "Any two or more railroad companies in this State . . . owning railroads . . . which . . . form one continuous line of railroad, continuing and running in the same general direction are hereby authorized to consolidate their stock and make joint stock with any connecting railroad company whether within or without this State, and form one company, owning and controlling such continuous line of road."

Sections 6740 and 6741 provide for the consolidation of domestic corporations with those of an adjoining State making a "continuous line." See also *ib.* § 6752.

*California.* Pomeroy's Civil Code 1901, § 473: "Any railroad company incorporated under the laws of this State may consolidate with one or more railroad companies incorporated under the laws of this State, or under the laws of any other State or Territory of the United States."

*Colorado.* Mill's Anno. Stat., § 604: "Any railroad company . . . of this State whose . . . road is made . . . to the boundary line of the State, or to any point either in or out of the State" may merge and consolidate with "any railroad company or companies . . . of any adjoining State or Territory whenever the two or more railroads of the companies or corporations . . . shall or may form a continuous line of railroad with each other or by means of an intervening railroad."

*Connecticut.* Gen. Stat. 1902, § 3674: "Any railroad corporation incorporated under the laws of this State for the purpose of building and operating railroads within this

state extending to or beyond the boundary line of this State may consolidate . . . with . . . any other incorporated railroad company whose line of road . . . is situated wholly outside this State."

*Delaware.* Laws 1903 (Corp. Law), § 91: "Any railroad of this State" may "consolidate with any other railroad company incorporated under the laws of this State, or any other State of the United States, whose railroads within or without this State shall connect, or form a continuous line, with the railroad of the company so consolidated."

For other railroad consolidation statutes see Laws 1903 (Corp. Law), § 123.

*Florida.* Gen. Stat. 1906, § 2812: "Any railroad . . . in this State shall have the power . . . to make and enter into contracts with any railroad . . . which has constructed or shall hereafter construct any railroad . . . within this State or in another State, as will enable said companies to run their road in connection with each other, and to merge their stock, or to consolidate with any company within or without this State."

*Georgia.* Code 1895, vol. 2, § 2179: "Any railroad company incorporated under the provisions of this article shall have authority . . . to consolidate the same with those of any other railroad company incorporated under the laws of this or any other State of the United States whose railroad within or without this State shall connect with or form a continuous line with the railroad of the company incorporated under this law upon such terms as may be agreed upon."

See also Code, § 2173.

*Idaho.* Code 1901, § 2178: "Any such railroad corporation [chartered



lines of railroad, although a varying phraseology is employed in expressing the legislative intention. The reason for pro-

by or organized under the laws of this State, or of any State or Territory or under the laws of the United States, and authorized to do business in this State], may consolidate its stock . . . with any other railroad corporation whether within or without the State, when such other railroad corporation does not own any competing line of railroad."

*Illinois.* Hurd's Rev. Stat. 1901, p. 1376, § 39: "Whenever any railroad which is situated partly in this State, and partly in one or more other States; and heretofore owned by a corporation formed by consolidation of railroad corporations of this or any other States, has been sold pursuant to the decree of any court . . . and the same has been purchased as an entirety, and is now, or . . . may be held in the name or as the property of two or more corporations, incorporated respectively under the laws of two or more of the States in which said railroad is situated, it shall be lawful for the corporation so created in this State to consolidate . . . with the . . . corporation or corporations of such other State or States. . . . Provided, that no consolidation shall take place with any railroad owning a parallel or competing line."

For act ratifying existing consolidations and mergers see Laws 1907, p. 473.

*Indiana.* Burns' Anno. Stat. Rev. 1901, § 5215: "Any railroad company incorporated under the provisions of this act shall also have power to consolidate with other railroad corporations in a continuous line either within or without this State upon such terms as may be agreed upon by the corporations owning the same." This act does not permit consolidation with other

*Indiana* railroads equipped and in operation.

For statutes permitting consolidation generally of steam or electric railroads see *ib.* §§ 5257, 5258, 5262. See also § 5468i.

*Iowa.* Code 1897, § 2036: "Any corporation organized under the laws of this State for the purpose of constructing and operating a railway may join, intersect, and unite its railway with that of any other corporation at such point upon the boundary line of this State as may be agreed upon, and . . . may merge and consolidate the stock, property, franchises, and liabilities of such corporations, making the same one corporation upon such terms as may be agreed upon not in conflict with the law."

*Kansas.* Gen. Stat. 1905, § 6325: "Any two or more railroad companies in this State, existing under general or special laws, and owning connecting lines of railroad in this State . . . and any railroad organized as aforesaid and any railroad company duly organized and existing under the laws of any other State or Territory, whose lines of railroad shall connect at the State line" may consolidate.

*Kentucky.* Stat. 1903, ch. 32: "Any two or more railroad companies . . . of this or any other State may . . . consolidate into a single company in the manner provided by article one of this chapter as amended."

*Louisiana.* Const. and Rev. Laws 1904, p. 1486: "Any railroad company or companies organized under the laws of this State, general or special, shall have the right and power to consolidate with any railroad company or companies organized under the laws, general or special, of any other State and form thereby a new corporation. . . ."

visions of this character is that the creation of the through line conduces to the public convenience and welfare by in-

*Louisiana.* Const. and Rev. Laws 1904, p. 1484: "Every railroad corporation in this State whether created under a general or special law, or existing by virtue of a charter or law of this or any other State," may consolidate with "any other railroad corporation of this or any other State whose road shall connect with or intersect the road of such railroad corporation or any branch thereof."

*Ib.* p. 1487 authorizes the consolidation of street railway companies.

*Maine.* Rev. Stat. 1903, § 30, p. 531. No railroad corporation can assign its charter or any rights under it; lease or grant the use or control of its road or any part of it, or divest itself thereof, without the consent of the legislature. But these provisions are not to be construed to prevent contracts between corporations allowing the trains of one to run over the road of another, both corporations assenting thereto.

*Maryland.* Pub. Gen. Laws, § 265, p. 650: "Any railroad company of this State" may "consolidate with any other railroad company incorporated under the laws of this or any other State, or of the United States, whose railroad within or without this State shall connect with or form a continuous line with the railroad of the company so consolidating."

*Ib.* § 278, p. 656: "Any railroad company incorporated under the three preceding sections shall have power to sell, lease, assign or transfer its stock, property and franchises to, or to consolidate the same with those of any other railroad company . . . of this or any other State, or of the United States, whose railroad within or without this State shall connect with or form a continuous line with the railroad of the Company incorporated under said sections."

*Massachusetts.* Supp. to Rev. Laws, 1902-06, p. 579, § 67: "A lease or purchase and sale of the franchise and property of a railroad corporation, or street railway company, and a consolidation of two or more railroad corporations, or street railway companies, whether authorized by general laws or a special act shall not be binding until . . . approved by board of railroad commissioners. . . ."

"Said board shall announce its decision within thirty days after the final hearing upon the application . . . for permission to lease or sell to, consolidate with or purchase the franchise and other property of, any other railroad corporation or street railway company."

*Michigan.* Pub. Acts 1899, p. 450, § 29: "Any railroad company in this State forming a continuous or connecting line with any other railroad company, may consolidate with such other company, either in or out of this State, or partly within or partly without this State."

*Minnesota.* Rev. Laws 1905, § 2897: "Any domestic or foreign railroad corporation . . . may consolidate its stock and franchises with any other railroad corporation whose lines of railroad . . . within or without this State can be lawfully connected and operated with such first named corporation, so as to constitute one continuous main line, . . . and admit of the passage of trains over them without break or interruption, and may become one corporation under any name selected by them."

*Mississippi.* Code 1906, § 4079: "Every railroad corporation organized under the provisions of this chapter shall have and exercise the following powers: (§ 4089) To consolidate

creasing facilities for travel and permitting lower rates, while the combination of separate and disconnected roads would

with any other railroad company in or out of this State, with the consent of the railroad commission, upon such terms as the consolidating companies may agree upon; but a consolidation shall not be made with a parallel or competing road."

*Missouri.* Anno. Stat. 1906, § 1059: "Any two or more railroad companies in this State, existing under either general or special laws, and owning railroads wholly or in part which, when completed and connected, will form in whole or in the main, one continuous line of railroad," are authorized to consolidate.

*Ib.* § 1060 provides for furnishing aid to and consolidating with connecting railroads.

*Montana.* Civil Code 1895, vol. 2, § 911: "Any two or more railroad corporations whose respective lines, not being parallel or competing lines, are wholly or partly within this State, whether chartered by or organized under the laws of the State or Territory of Montana or of the United States, or of any other State or Territory, when their respective lines of road, or any branch thereof, so connect within this State that they may operate together as one property, may consolidate."

*Ib.* § 890: "Any railroad corporation . . . may consolidate with any road not a parallel or competing line."

*Ib.* § 923 provides for consolidation of domestic with domestic or foreign railroads.

*Nebraska.* Comp. Stat. 1905, § 2023, p. 528: "Whenever the lines of railroad of any railroad companies in this State, or any portion of such lines, have been or may be constructed, so as to admit passage of burden or passenger cars over any

two or more of such roads continuously, without break of gauge or interruption," such companies may consolidate.

*Nevada.* Comp. Stat. (1861-90, Cutting), § 1011: "Two or more railroad companies" may "amalgamate and consolidate their capital stock, debts, property, assets, and franchises."

*New Hampshire.* Pub. Stat. 1901, ch. 156, § 22 (p. 503): "If two or more railroad corporations at meetings of their respective stockholders . . . have agreed by a two-thirds vote of the stock represented and voting at such meetings, to unite and form a single corporation," a petition is presented to the Supreme Court to see whether the public good will be promoted by such a union, and if the court determine that the public good requires it, the other conditions being complied with, it shall authorize the union to be made.

*New Jersey.* Laws 1906, ch. 141, § 2: "Any railroad company of this State may lease its road, or any part thereof, to any other railroad company of this or any other State, or may take a lease of the road, or any part thereof, of any other railroad company of this or any other State, or may unite and consolidate as well as merge its stock, property, franchises and road with those of any other company or companies of this or any other State, or may do both, . . . ; such leasing or consolidation may be made where the roads of the said companies connect either directly or over the intervening line of one or more other railroad companies; no such lease, union, consolidation or merger shall take effect until the parties thereto file in the office of the Secretary of State an agreement surrendering to the State

not only serve no public purpose but might tend to prevent competition.

all rights of exemption and contract privileges with respect to taxation, and reserving to the State any existing right to take the property of any of the parties."

*New Mexico.* Comp. Laws 1897, § 3892: "Any railroad company . . . organized under the law of this Territory or of this Territory and any other Territory or State . . . operating . . . either wholly within or partly within and partly without this Territory," may consolidate "with "any other railroad company or companies organized under the laws of this Territory, or under the laws of this Territory and any other Territory or State whenever the two or more railroads . . . shall or may form a continuous line of railroad with each other, or by means of an intervening railroad, bridge, or ferry."

*New York.* Birdseye's Rev. Stat. 3d ed., p. 2961 (Railroad Law § 70): "Any railroad or other corporation, organized under the laws of this State, or of this State and any other State, and owning or operating a railroad . . . either wholly within or partly within and partly without the State, or whose lines or routes of road have been located but not constructed, may merge and consolidate its capital stock, franchises, and property with the capital stock, franchises, and property of any other railroad . . . corporation or corporations organized under the laws of this State, or of this and any other State, or under the laws of any other State or States, whenever the two or more railroads of the companies or corporations, so to be consolidated, . . . or branches of any part thereof, or the line or routes of their roads if not constructed, shall or may form a continuous or connected line of railroad with each other

or by means of an intervening railroad bridge, tunnel, or ferry."

*Ib.* (Railroad Law, § 80) p. 2966: "No railroad corporation or corporations owning or operating railroads whose roads run on parallel or competing lines, except street surface railway corporations, shall merge or consolidate or enter into any contract for the use of their respective roads or lease the same, the one to the other, unless the board of railroad commissioners of the State or a majority of such board shall consent thereto."

*North Dakota.* Rev. Codes 1899, § 2954: "Any railroad corporations, organized and existing under the laws of the Territory of Dakota or State of North Dakota or existing by consolidation of different railway companies under the laws of such Territory or State, and of any other Territory or State, may consolidate . . . with any other railroad corporation, whether within or without the State, when their respective railroads can be lawfully connected and operated together to constitute one continuous main line."

*Ohio.* Bates Anno. Stat. (1787-1906), § 3379: "When the lines of road of any railroad companies in this State, or any portion of such lines, have been or are being so constructed as to admit the passage of burthen or passenger cars over any two or more of such roads continuously, without break or interruption, such companies may consolidate."

*Ib.* § 3380: "A company organized in this State . . . whose line of road is made or is in process of construction to the boundary line of this State, or to any point either in or out of this State, may consolidate . . . with . . . any company in an adjoining State . . . whose line

With few exceptions these statutes permit corporations of the State to consolidate with corporations of other States own-

of road has been projected . . . or is in process of construction, to the same points when the several roads so united or constructed will form a continuous line for the passage of cars."

*Ib.* 3380a authorizes a corporation formed by consolidation to further consolidate.

*Oklahoma.* Rev. and Anno. Stat. 1903, § 99, p. 360: "Any railroad corporation may consolidate its stock, franchises, and property with any other railroad corporation, whether within or without the Territory, when their respective railroads can be lawfully connected and operated together to constitute one continuous main line with or without branches."

*Oregon.* Bellinger & Cotton's Anno. Codes and Stat. (1902), § 5056: "Any two or more railroad companies whose lines are connected may perfect any arrangement for their common benefit to assist and promote the object for which they were created."

*Pennsylvania.* Bright. Purd. Dig. 1894, § 107, p. 1801: "It shall be lawful for any railroad company chartered by this commonwealth to merge its corporate rights . . . into any other railroad company so chartered, connecting therewith."

*Ib.* § 114, p. 1803: "Any railroad company or corporation, organized under the laws of this commonwealth, and operating a railroad, either in whole within, or partly within and partly without this State," may "merge and consolidate . . . with any other railroad company or companies or corporations organized and operated under the laws of this or any other State, whenever the two or more railroads . . . shall or may form a continuous line of railroad with each other, or by means of an intervening railroad."

*Ib.* § 126, p. 1805: "Any railroad company or corporation duly organized under the laws of this State . . . operating a railroad either wholly or partly within and partly without this State," may "consolidate . . . with any other railroad companies or corporations organized under the laws of this or any other State, whenever the two or more railroads of the companies or corporations . . . shall or may form . . . a continuous line of railroad with each other, or by means of any intervening railroad; and such consolidation may be effected in accordance with the laws of this commonwealth, and either under special or general statutes of other States."

*Ib.* § 182, p. 1814, authorizes consolidation of particular railroads.

*South Carolina.* Code 1902, § 2050: "Any railroad company . . . of this State, operating a railroad whether wholly within, or partly within and partly without, this State," may "merge and consolidate . . . with any other railroad company or companies organized and operated under the laws of this or any other State, whenever two or more railroads of the companies . . . are continuous or are connected with each other or by means of an intervening railroad."

*Ib.* § 2034: "Such company [railroad] shall have full power and authority . . . to purchase, lease, or consolidate with any other railroad or railroads in or out of this State in such manner and upon such terms as may be agreed between such railroad companies."

*South Dakota.* Rev. Code, § 494, p. 649: "Any company owning or operating a railroad within this State may extend its road into any other State or Territory, and may build,

ing connecting roads, as well as with other domestic railroad corporations.

buy, lease, or be consolidated with any railroad or railroads in such other State or Territory."

*Tennessee.* Code 1896, § 1522: "Every railroad corporation existing in this State . . . or . . . of any other State . . . and having authority to operate and maintain a railroad in this State, shall have power to consolidate itself with any other railroad corporation, whose road shall connect with or intersect the road of such existing railroad corporation or branch thereof."

*Ib.* § 1532 also authorizes consolidation.

*Texas.* Sayles' Texas Civil Stat. 1897 (Supp. to 1900), Art. 4531: "No railroad company organized under the laws of this State shall consolidate . . . with any railroad company organized under the laws of any other State or of the United States."

*Utah.* Laws 1901. ch. 26, § 6: "Any railroad company organized or existing under the laws of this State" may "merge or . . . consolidate with any other railroad company or companies organized or existing under the laws of this or any other State or Territory or of the United States; provided that the lines of such companies shall not be competing, but shall be substantially continuous or connective, either by means of actual union of track or through the medium of any bridge, ferry, or line of railroad, leased."

*Vermont.* Stat. 1894, § 3975: "When a railroad in this State" is ordered sold by decree or judgment of a court, "any railroad company in this State, whose railroad connects with that ordered to be sold, may purchase the same, and upon acquiring title to said railroad, consolidate it with its own railroad and make it a part thereof."

*Virginia.* Code 1904, § 1105b: "A railroad company shall have power: . . . (e) To consolidate or merge itself, purchase or lease the works, property and franchises, . . . of any railroad company incorporated under the laws of this State or another State, or of this State and another, or other States, or under the laws of the United States, and to sell or lease its works, property, and franchises or any part thereof, to any other such corporation . . . of this State; provided, however, that nothing in this act shall authorize or be construed to permit the purchase, lease, sale, consolidation or merger of the works, property or franchise of railroads competitive with it between points, both of which are in this State, or lines between the same terminal points, both of which are within this State, whether such lines be operated by the same or different motive power."

*Washington.* Ballinger's Anno. Code 1897, §§ 4303, 4304: "Any railroad corporation chartered by or organized under the laws of the State, or of any State or Territory, or under the laws of the United States . . . may consolidate . . . with any other railroad corporation, whether within or without the State, when such other railroad does not own any competing line."

*West Virginia.* Code 1906, § 2346: "No railroad corporation, owning or operating a railroad wholly or in part within this State, shall consolidate its capital stock with any other railroad corporation owning a parallel . . . line, . . . but any such railroad corporation whose line of railroad is made, or is in process of construction," may consolidate with "any other corporation of this or of an adjoining State, owning or operating a

The statutes, generally, contain provisions against the consolidation of competing or parallel railroads.

§ 23. **What Corporations other than Railroads may consolidate — Statutory Provisions.** — Statutes authorizing the consolidation of private corporations and of other public service corporations than railroad companies have been adopted in many of the States. An abstract of them is printed in the footnote.<sup>1</sup>

line of railroad . . . wholly or partly within this or an adjoining State, and connected directly, or by means of an intervening railroad or railroads, in order to make a continuous line of railroad to be run and operated without change of cars, break of bulk or exchange of passengers or freight."

"It shall be lawful for any railroad company created under the laws of this State, or of this and any other State or States, to consolidate with any railroad or railroads in this State or other States."

"Where two or more railroad companies have been heretofore incorporated under, and by virtue of the laws of this State, for the construction of two or more lines of railroad, which have been located or surveyed along the same line between any points and places, . . . the Boards of Directors of said corporations" may "consolidate the capital stock of their respective companies, or . . . consolidate different interests in the same road."

*Wisconsin.* Sanborn's Stat. Supp. (1899-1906), vol. 3, § 1833, p. 919: "Any railroad corporation organized and existing under the laws of the Territory or State of Wisconsin, or existing by consolidation of different railway companies under said laws and the laws of any other Territory or Territories, State or States, may consolidate . . . with any other railroad corporation whether within or without the State, when their respective railroads can be lawfully con-

nected and operated together to constitute one continuous main line, with or without branches."

*Wyoming.* Rev. Stat. 1899, § 3202: "Whenever a line of railroad of any railroad company in this State, or any portion of said line, has been constructed so as to connect with any two or more of such roads," said companies may consolidate.

*Ib.* § 3206: "Any company owning or operating a railroad within this State may extend the same into any other State or Territory, and may . . . consolidate with any other railroad or railroads in such other State or Territory, or with any other railroad in this State, and may operate the same."

<sup>1</sup> *Alabama.* Gen. Laws 1903, p. 132: "Any two or more existing corporations other than corporations having the right to condemn to their use rights of way and other easements over the property of others whether created by special acts or organized under the general incorporation laws of this State, may consolidate so as to form a single corporation. . . ."

*California.* Stat. and Am'n'dts. to Codes 1905, p. 585, § 587a, authorizes the consolidation of corporations organized for "mining purposes."

*Ib.* p. 598, § 653i, authorizes consolidation of "coöperative business associations."

*Colorado.* Gen. Stat. 1891, § 628: "Any corporations existing for any of the purposes enumerated in this (general) act" may consolidate.

These statutes vary in their provisions and relate to many different kinds of corporations. As a general rule those relat-

*Connecticut.* Pub. Acts 1903, ch. 194, § 75, provides that corporations "carrying on business of the same or a similar nature may merge or consolidate."

*Delaware.* Gen. Corp. Law 1903, § 59: "Any two or more corporations organized . . . for the purpose of carrying on any business may consolidate. . . ."

Laws 1905, ch. 155, § 2, authorizes the consolidation of telegraph and telephone companies.

*Idaho.* Rev. Stat. 1887, § 2804: "Any two or more such corporations (land and building) may unite and become incorporated in one body."

*Illinois.* Starr & Curtis' Anno. Stat. 1903, Supp. p. 129, provides that it shall apply only "to corporations of the same kind and engaged in the same general business and carrying on their business in the same vicinity and that no more than two corporations now existing shall be consolidated into one," under its provisions.

*Ib.* 1902 Supp. authorizes gas companies to consolidate.

*Ib.* vol. 1, p. 518, § 15, authorizes the consolidation of corporations with banking powers.

*Indiana.* Burn's Rev. Stat. 1901, § 4662. Bridge companies may by a vote of a majority of its directors consolidate with any other bridge companies of any other State having authority to construct a bridge at same point.

*Ib.* § 4790. Plank, macadamized or gravel road companies may consolidate.

*Ib.* § 4836. A hydraulic company may consolidate with any other hydraulic company in any case where the hydraulic works form a continuous line.

*Ib.* § 5423. River navigation companies may consolidate.

Acts 1907, ch. 156, § 2. Electric light and power company may merge with any hydraulic company where purpose of merger is to use the water power, etc. of hydraulic company for generation of electricity.

*Iowa.* Supp. to Code 1902, § 1907b, authorizes the consolidation of building and loan associations.

*Kansas.* Gen. Stat. 1905, § 1414: "Any telegraph company . . . of this State, may . . . unite or consolidate with any other company or companies . . . of any State. . . ."

*Ib.* § 1492. Any two or more building and loan associations may consolidate.

*Ib.* § 1510. Bridge company of this State and one of adjoining State may consolidate where they have authority to build bridge at same point.

*Kentucky.* Acts 1902, ch. 58, § 2: "Any two or more corporations organized under this charter, or the laws of this or any other State may consolidate into a single corporation."

*Louisiana.* Rev. Laws 1904, p. 246: "Any two business and manufacturing companies now existing under general or special law, whose objects and business are, in general, of the same nature" may amalgamate.

*Maine.* Rev. Stat. 1903, § 56, p. 443: "No corporation shall sell, lease or in any manner part with its franchises except with the consent of its stockholders at an annual or special meeting, the call for which shall give notice of the subject-matter of the proposed sale, lease or consolidation. All such sales, leases and consolidations shall be made subject to the provisions of this and the eleven following sections. . . ."



ing to business corporations limit the right of consolidation to corporations of a particular kind, *e.g.*, mining or manufacturing

*Maryland.* Pub. Gen. Laws (1904), p. 552, § 45, authorize consolidation "when the corporators have been originally incorporated in whole or in part for the same purpose."

*Ib.* p. 673, § 327, authorizes the consolidation of telegraph companies.

*Michigan.* Laws of 1903, Art. 50, authorizes the consolidation of street railway, electric and gas light companies or any two thereof.

*Missouri.* Anno. Stat. 1906, § 1334, provides that "any two corporations now existing . . . whose objects and business are in general of the same nature may amalgamate," but the statute applies "only to corporations organized or created solely for manufacturing purposes."

*Ib.* § 1221 authorizes the consolidation of macadam, gravel and plank road companies.

*Ib.* § 1262 authorizes the consolidation of telegraph companies.

*Ib.* § 1353 authorizes the consolidation of bridge companies whose bridges connect.

*Ib.* § 1376 authorizes consolidation of building and loan associations.

*Ib.* § 7889 relates to the consolidation of insurance companies.

*Montana.* Civ. Code 1895, § 527: "It is lawful for two or more companies formed for mining purposes, which own or possess, mining claims or lands adjoining each other, or lying in the same vicinity, to consolidate."

*Ib.* § 817 authorizes consolidation of building, loan and savings corporation.

*Ib.* § 1015 relates to the consolidation of mining companies.

*Nevada.* Stat. 1903, ch. 88, § 43: "Any two or more corporations organized under the provisions of this act, or existing under the laws of this State, for the purpose of carrying on

any kind of business, may consolidate into a single corporation which may be either one of said consolidating corporations, or a new corporation to be formed by means of such consolidation."

*New Jersey.* Corp. Act of 1896, § 104-109, provides that "any two or more corporations organized or to be organized under any law or laws of this State for the purpose of carrying on any kind of business of the same or a similar nature may merge or consolidate," but the provisions of the act do not apply to railroad, insurance (except title insurance), banking, turnpike, or canal companies nor to savings banks, or other corporations intended to derive profits from the loan or use of money."

*New Mexico.* Laws 1905, § 109: "Any two or more corporations organized under any law or laws of this territory for the purpose of carrying on any kind of business of the same or a similar nature may merge or consolidate into a single corporation, which may be either one of said merging or consolidating corporations, or a new corporation to be formed by means of such merger and consolidation."

*New York.* Business Corp. Law (as amended), § 8: "Any two or more corporations organized under the laws of this State for the purpose of carrying on any kind of business of the same or similar nature, which a corporation organized under this chapter might carry on, may consolidate."

*Texas.* Rev. Stat. 1895, Art. 651, subdiv. 9, authorizes the consolidation of corporations created for benevolent, charitable, educational and similar purposes.

*Utah.* Rev. Stat. 1898, § 340: "Corporations of the same kind en-

companies, or to corporations organized for the purpose of carrying on business of the same or similar nature, and a few of the statutes require that such business shall be carried on in the same locality.

§ 24. **Power of Legislature to withdraw or limit Right to consolidate — (A) In Absence of Reserved Power.** — It has been held that a grant of power to consolidate in the charter of a corporation constitutes a contract between the corporation and the State and that, in the absence of a reserved right to amend or repeal the charter, such power cannot be withdrawn or limited by subsequent legislation.<sup>1</sup> But this is not the correct rule. Provisions of this character in charters fall within the class of grants which, as observed by Mr. Justice Peckham in *Bank of Commerce v. Tennessee*,<sup>2</sup> “do not partake of the nature of a contract, which cannot for that reason be in any respect altered or the power recalled by subsequent legislation. When no act is done under the provision and no vested right is acquired prior to the time when it was repealed, the provision may be validly recalled, without thereby impairing the obligation.”<sup>3</sup>

The power, therefore, granted to a corporation to consolidate is a mere *license*, not resting in contract, which may be rendered

gaged in the same general business in the same vicinity” may consolidate.

*Virginia*. Code 1904, § 1105e: “Except as any merger or consolidation is prohibited by . . . this act, any corporation . . . of this State may merge or consolidate into a single corporation with any other corporation organized for the purpose of carrying on the same or a similar business under the laws of this or any other State of the United States, or under the laws of the United States.”

<sup>1</sup> *Zimmer v. State*, 30 Ark. 680 (1875): “The power here given the company to form a union or consolidation with any other company was a right secured by the inviolability of a contract between the State and company, which could not be withdrawn or to any extent impaired by the State.”

But in view of the later decision of the Supreme Court of Arkansas in *St. Louis, etc. R. Co. v. Berry*, 41 Ark. 509 (1883), this language must be regarded as mere *dicta* and without authority even in Arkansas. It was never good law outside that State.

<sup>2</sup> *Bank of Commerce v. Tennessee*, 163 U. S. 425 (1896), (16 Sup. Ct. Rep. 1113).

<sup>3</sup> *Galveston, etc. R. Co. v. Texas*, 170 U. S. 226 (1898), (18 Sup. Ct. Rep. 603); *Adams v. Yazoo, etc. R. Co.*, 77 Miss. 194 (1899), (24 So. Rep. 200, 60 L. R. A. 33 n.), *affirmed sub nom. Yazoo, etc. R. Co. v. Adams*, 180 U. S. 1 (1901), (21 Sup. Ct. Rep. 240). See also *Pearsall v. Great Northern R. Co.*, 161 U. S. 646 (1896), (16 Sup. Ct. Rep. 705).

inoperative by legislation enacted at any time before the corporation avails itself of the privilege granted; and such power exists in the legislature independent of any right reserved to amend or repeal the charter or of its police power.

If power to consolidate, while unexecuted, is not a contract within the protection of the decision in the Dartmouth College case, *a fortiori* it is not, in itself, a vested right which the legislature may not take away or impair. Arrangements for consolidation made and carried into effect create vested rights, but the bare power to consolidate is not of that nature.<sup>1</sup>

General power to consolidate authorizes the consolidation of competing lines of railroad, and constitutional and statutory provisions against consolidation in that form furnish the most

<sup>1</sup> In *Pearsall v. Great Northern R. Co.*, 161 U. S. 672 (1896), (16 Sup. Ct. Rep. 705), Mr. Justice Brown discusses the questions suggested in the text, although in that case the statutes forbidding consolidation expressly protected "vested rights". "It is possible that, if this arrangement had been actually made and carried into effect, before the acts forbidding the consolidation of parallel or competing lines had been passed, the rights of the parties thereto would have become vested, and could not be impaired by any subsequent act of the legislature. But the real question before us is whether a bare unexecuted power to consolidate with other corporations, a power which, if it exists as claimed by the defendant, would authorize it to absorb by successive and gradual accretions the entire railway system of the country, is not, so long as it remains unexecuted, within the control of and subject to revocation by the legislature, at least, so far as it applies to parallel or competing lines. . . . As applied to railroad corporations, it may reasonably be contended that the term [vested rights] extends to all rights of property acquired by executed contracts, as well as to all such rights as are necessary to the full and

complete enjoyment of the original grant, or of property legally acquired subsequent to such grant. If, for example, the legislature should authorize the construction of a certain railroad, and by a subsequent act should take away the power to raise funds for the construction of the road in the usual manner by a mortgage, or the power to purchase rolling stock or equipment, such acts might perhaps be treated as so far destructive of the original grant as to render it valueless, although there might in neither case be an express repeal of any of its provisions. But where the charter authorizes the company in sweeping terms to do certain things which are unnecessary to the main object of the grant, and not directly or immediately within the contemplation of the parties thereto, the power so conferred, so long as it is unexecuted, is within the control of the legislature and may be treated as a license, and may be revoked, if a possible exercise of such power is found to conflict with the interests of the public."

See also *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 677 (1896), (16 Sup. Ct. Rep. 714).

common illustration of limitations imposed upon existing rights of consolidation.<sup>1</sup>

§ 25. **Power of Legislature to withdraw or limit Right to consolidate — (B) In Exercise of Reserved Power.** — Whatever doubt may exist as to the constitutional authority of the legislature to withdraw an existing unexecuted right to consolidate in the absence of a power reserved to amend or repeal the law granting the right, when such reservation has been made legislative authority to limit or take away the right is unquestionable.<sup>2</sup>

The reservation of power to alter or amend a charter, however, gives the legislature no power to impair vested rights of property — except, of course, for a public use upon just compensation — and a provision in an act forbidding the consolidation of competing railroads that it shall not affect vested rights is merely declaratory.<sup>3</sup> A stipulation in an act repealing the power to consolidate theretofore granted to certain corporations, that such repeal shall not “affect or impair any act done or right accruing, accrued, or acquired” before a certain date does not affect consolidation proceedings commenced, but not concluded, before such time, and they may be completed entirely unaffected by the repealing act.<sup>4</sup>

§ 26. **Power of Legislature to withdraw or limit Right to consolidate — (C) In Exercise of Police Power.** — There is another principle, applicable to railroad companies and other corporations assuming the performance of public duties, upon which the legislature may withdraw the power of consolidating, if the exercise of such power may conflict with the public interests, and that is the principle that the State has the right to guard the welfare of its citizens — the police power. In the exercise of its police power the State may prohibit the

<sup>1</sup> See *post*, § 32: “*Constitutional and Statutory Provisions against Consolidation of Competing Railroads.*”

<sup>2</sup> *Pearsall v. Great Northern R. Co.*, 161 U. S. 672 (1896), (16 Sup. Ct. Rep. 705); *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 695 (1896), (16 Sup. Ct. Rep. 714).

<sup>3</sup> *Pearsall v. Great Northern R. Co.*,

161 U. S. 672 (1896), (16 Sup. Ct. Rep. 705). See *ante*, § 24: “*Power of Legislature to withdraw or limit Right to consolidate — In Absence of Reserved Power.*”

<sup>4</sup> *Cameron v. New York, etc. Water Co.*, 133 N. Y. 336 (1892), (31 N. E. Rep. 104).

consolidation of competing railroads, although their charters authorize consolidation, provided the authority has not been exercised and vested rights acquired. It is also immaterial whether a grant of power to consolidate is a contract or a license or whether a right to amend or repeal is reserved, for the constitutional prohibition of legislation impairing the obligation of contracts does not exempt a corporation from the exercise of the police power of the State.

In *Louisville, etc. R. Co. v. Kentucky*<sup>1</sup> Mr. Justice Brown said: "Under the police power the people, in their sovereign capacity, or the legislature, as their representative, may deal with the charter of a railway corporation, so far as is necessary for the protection of the lives, health, and safety of its passengers or the public, or for the security of property or the conservation of the public interests, provided, of course, that no vested rights are thereby impaired. In other words, the legislature may not destroy vested rights, whether they are expressly prohibited from doing so or not, but otherwise may legislate with respect to corporations, whether expressly permitted to do so or not. While the police power has been most frequently exercised with respect to matters which concern the public health, safety, or morals, we have frequently held that corporations engaged in public services are subject to legislative control, so far as it becomes necessary for the protection of the public interests."

### III. *Construction of Statutes authorizing Consolidation*

§ 27. **General Rules of Construction.** — The Chancellor of New Jersey once intimated<sup>2</sup> that acts authorizing the consolidation of corporations relate rather to the transfer of existing

<sup>1</sup> *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 695 (1896), (16 Sup. Ct. Rep. 714). See also *Pearsall v. Great Northern R. Co.*, 161 U. S. 672 (1896), (16 Sup. Ct. Rep. 705); *Gibbs v. Consolidated Gas Co.*, 130 U. S. 407 (1889), (9 Sup. Ct. Rep. 553).

<sup>2</sup> *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 402 (1871): "This act can hardly be considered a grant from the State, or to fall within the rule re-

quiring strict construction in all such grants. The State here parts with no property and creates no new privilege or franchise that can affect the public. It simply permits a new arrangement or contract as to privileges and franchises already granted. It enlarges none."

The contract under consideration in this case was a lease, but the statute also authorized consolidation.

rights than to the creation of new ones and are not subject to the strict rules of construction applicable to original grants of corporate powers. But the Supreme Court in reversing the decree of the Chancellor<sup>1</sup> laid down the rule that a grant from the State "will not be deduced from the words of a statute, except when it contains language not susceptible of any other rational construction." The correct rule, in determining the existence of authority to consolidate, is that a statute should receive a strict, but not unreasonable, construction.

The question whether authority to consolidate must be expressly conferred upon each consolidating corporation has occasioned a division of judicial authority. On the one hand, it has been held that where power is given by statute to one corporation to unite with *any other*, whatever other corporation it selects and agrees with for the union has, by implication, power to unite with it, although such other corporation is not named in the act and has not, otherwise, power to consolidate.<sup>2</sup> The reason given for this conclusion is that the power granted to one corporation to consolidate necessarily involves the same power in the other company and so operates impliedly as an enlargement of its charter.<sup>3</sup> On the other hand, it has been held that *all* the constituent corporations must have the power to consolidate in order to effect a valid consolidation — that power to consolidate with any other corporation means, reasonably, any other corporation having power to consolidate.<sup>4</sup> The latter conclusion is more in ac-

<sup>1</sup> *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 455 (1873).

<sup>2</sup> *Matter of Prospect Park, etc. R. Co.*, 67 N. Y. 377 (1876): "The act . . . gave power to one of the corporations, which now together form the corporation which is the petitioner in this case, to consolidate with any other like corporation. The point of the appellants, that no power to consolidate is given to the other of those corporations, is without effect. Power is given by statute to one corporation to form a consolidation with *any other*. It cannot form a consolida-

tion unless it finds another with which to unite and which is capable of union with it; hence whatever other company it selects for a union, and finds willing to join it, that other company, though not named in the statute, gets power from the statute to unite with that company which the statute names."

<sup>3</sup> *New York, etc. R. Co. v. New York, etc. R. Co.*, 52 Conn. 274 (1884). See also *Knoxville v. Knoxville, etc. R. Co.*, 22 Fed. 763 (1884).

<sup>4</sup> In *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 691 (1896), (16 Sup.

cordance with the rule of strict, yet reasonable, construction. It has also been held, upon a principle which is at least doubtful, that the fact that the right of one company to consolidate is limited under its charter does not deprive it of the right to consolidate under the general laws of the State.<sup>1</sup>

Ct. Rep. 714), Mr. Justice Brown said: "Besides this, however, in order to support the proposed consolidation of these two systems, the parties are bound to show, not only that the L. & N. Co. was competent to buy, but that the Chesapeake Co. was also vested with power to sell. To make a valid contract it is necessary to show that both parties are competent to enter into the proposed stipulations. It is a fundamental principle in the law of contracts that, to make a valid agreement, there must be a meeting of minds, and, obviously, if there be a disability on the part of either party to enter into the proposed contract there can be no valid agreement."

See also *St. Louis, etc. R. Co. v. Terre Haute R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953).

In *Morrell v. Smith County*, 89 Tex. 529 (1896), (36 S. W. Rep. 56), it was held that authority given a railroad company by its charter, to consolidate with any other company, does not confer authority upon another company to consolidate with it: and the power is, in effect, limited to a union with another company having like power. In this case the Court declined to follow the rule laid down in *Matter of Prospect Park, etc. R. Co.*, 67 N. Y. 377 (1876). See also *East Line, etc. R. Co. v. Rushing*, 69 Tex. 306 (1887), (6 S. W. Rep. 834); *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690), and dissenting opinion in *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 275 (1881). That the same principle is applicable in the case of interstate consolidations

see *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153); *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 642 (1897).

In England it has been said that an agreement cannot be made by which one railroad company shall turn over its railway to be worked by another company unless the latter possesses, under its charter, power to receive and work it. *Winch v. Birkenhead, etc. R. Co.*, 16 Jur. 1035 (1835).

<sup>1</sup> *Warrener v. Kankakee County*, 1 Monthly West. Jur. 556 (1875), (Fed. Cas. No. 17205) (per Blodgett J.): "The right of the company to consolidate, under its charter, seemed limited, but that did not take away the right from the company to consolidate under the general law of the State by complying with all the provisions of the law."

A statute authorizing the filing of amended certificates of incorporation and providing that the amended certificate shall take the place of the original has a retroactive effect in curing errors and defects in the original, but the filing of such amended certificate does not so far relate back as to deprive the corporation of the right to consolidate under a statute passed subsequent to its original organization, but before the filing of the amendment.

*Colgate v. U. S. Leather Co.*, 67 Atl. Rep. 657, (N. J. 1907).

In this case it was also held that the fact that the statute provided that nothing should be inserted in the amended certificate not in conformity with the law under which the corpora-

§ 28. **Construction of Particular Statutory Provisions.** — An act authorizing the consolidation of two corporations authorizes, by reasonable intendment, the consolidation of more than two;<sup>1</sup> and it has been held that a statute providing for the consolidation of corporations, but upon the condition "that no more than two corporations now existing shall be consolidated into one under the provisions hereof," authorized the consolidation of more than two corporations if only two of them were in existence at the time of the passage of the act.<sup>2</sup>

A consolidation act authorizing the consolidation of "railroad companies" has been held to include *street* railroad companies.<sup>3</sup> When the words "any other railroad" or similar words are used in a charter or statute authorizing consolidation, without restricting them to domestic corporations, they include foreign railroad companies as well.<sup>4</sup>

A statute providing that, in case of consolidation, the consolidated corporation shall be liable for the debts of the constituent companies does not, in itself, authorize consolidation.<sup>5</sup>

A grant of power to connect or unite with another road refers merely to a physical connection of the tracks and does not authorize any union of the franchises of the two corporations or their consolidation. Power to consolidate cannot be inferred from any such indefinite language as "to unite and connect with such road."<sup>6</sup>

tion was organized, did not prevent the insertion of provisions for consolidation, although consolidation was authorized after the organization of the corporation.

<sup>1</sup> *People v. Rice*, 66 Hun (N. Y.) 130 (1892), (21 N. Y. Supp. 48), *affirmed* 138 N. Y. 614 (1893), (33 N. E. Rep. 1083).

<sup>2</sup> *Barrows v. People's Gas Light, etc. Co.*, 75 Fed. 794 (1895).

<sup>3</sup> *Matter of Washington St., etc. R. Co.*, 115 N. Y. 442 (1889), (22 N. E. Rep. 356), *affirming* 52 Hun 311 (1889), (5 N. Y. Supp. 355). See, however, *Philadelphia v. Thirteenth St., etc. Co. (Pa.)*, 1 Leg. Gaz. Rep. 165 (1871).

<sup>4</sup> *Pittsburg, etc. R. Co. v. Keokuk, etc. Bridge Co.*, 131 U. S. 371 (1891), (9 Sup. Ct. Rep. 770); *St. Louis, etc. R. Co. v. Terre Haute R. Co.*, 145 U. S. 403 (1892), (12 Sup. Ct. Rep. 953); *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 393 (1888), (23 Atl. Rep. 529).

*Contra*, *Black v. Delaware, etc. R. Co.*, 24 N. J. Eq. 455 (1873).

<sup>5</sup> *Kavanaugh v. Omaha Life Ass'n.*, 84 Fed. 295 (1897).

<sup>6</sup> *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 684 (1896), (16 Sup. Ct. Rep. 714): "By the act . . . the company was given power to *unite* their road with any other road connecting therewith upon such condi-



While the authorities are not uniform upon the question whether a grant of power to consolidate with a railroad company gives power to sell to that company,<sup>1</sup> the converse of

tions as the two companies might agree upon. As we have frequently held that a power to connect or unite with another road refers merely to a physical connection of the tracks and does not authorize the purchase or even the lease of such road, or any union of their franchises, it is evident that this act is no authority for the proposed consolidation. . . The important power to purchase or consolidate with another line cannot be inferred from any such indefinite language as 'to unite or connect with such road.'

See also *Atchison, etc. R. Co. v. Denver, etc. R. Co.*, 110 U. S. 667 (1884), (4 Sup. Ct. Rep. 185); *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094); *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409); *St. Louis, etc. R. Co. v. Terre Haute R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953); *Morrell v. Smith County*, 89 Tex. 529 (1896), (36 S. W. Rep. 56).

<sup>1</sup> In *Branch v. Jesup*, 106 U. S. 478 (1882), (1 Sup. Ct. Rep. 495), the Supreme Court of the United States said: "As a general rule, it is true, a railroad company, with only the ordinary powers to construct and operate its road, cannot dispose of it to another company. Legislative aid is necessary to that end. But this company had, by its charter, express power to incorporate its stock with the stock of any other company. This power has an enlarging effect upon the ordinary power to sell and dispose of property belonging to the company. Generally the power to sell and dispose has reference only to transactions in the ordinary course of business incident to a railroad company, and does not extend to the

sale of the railroad itself, or of the franchise connected therewith. Outlying lands, not needed for railroad uses, may be sold. Machinery and other personal property may be sold. But the road and franchises are generally inalienable; and they are so not only because they are acquired by legislative grant, or in the exercise of special authority given, for the specific purposes of the incorporating act, but because they are essential to the fulfilment of those purposes; and it would be a dereliction of the duty owed by the corporation to the State and to the public to part with them. But where, as in this case, power is given to incorporate the capital stock with the stock of any other company, a very large addition is made to the ordinary powers granted to a company. In this country the creation and exercise of such a power is well understood. It contemplates not only the possible transfer of the railroad and its franchises to another company, but even the extinguishment of the corporation itself, and its absorption into a different organization. *The greater power of alienating or extinguishing all its franchises, including its own being and existence, contains the lesser power of alienating its road and the franchises incident thereto and necessary to its operation.*"

On the other hand, in the case of *Tippicanoe County v. Lafayette, etc. R. Co.*, 50 Ind. 110 (1875), the Supreme Court of Indiana said: "That act is 'to authorize railroad companies to consolidate their stock with the stock of other railroad companies in this or in an adjoining State, and to connect their roads with the roads of said companies.' The title nowhere mentions a lease or a sale. Indeed, the words to connect their

the proposition was adopted in reference to an Illinois statute, that power to purchase, in the form there granted, gave power to consolidate. "While the statute denominates the transaction a purchase, the thing authorized to be done, and what was done in the case, was in fact a consolidation."<sup>1</sup>

A statute providing that any two or more corporations organized under the laws of the State may consolidate authorizes the consolidation of a college and a university. And if the method of consolidation is indicated by the act it is immaterial that its provisions are more particularly adapted to corporations having capital stock.<sup>2</sup>

§ 29. **Construction of Statutes authorizing Consolidation of Railroads — Connecting or Continuous Lines.** — As already shown<sup>3</sup> the consolidation statutes of a majority of the States provide that railroad companies may consolidate with other corporations owning railroads which form a continuous or

roads with the roads of other companies, would seem to exclude such a conclusion. To connect one road with another does not fairly mean to lease or sell it to another." See also *East Line, etc. R. Co. v. State* 75 Tex. 434 (1889), (12 S. W. Rep. 690).

<sup>1</sup> *Chicago, etc. R. Co. v. Ashling*, 56 Ill. App. 327 (1894); *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 642 (1897).

<sup>2</sup> *Central University v. Walter* (Ky. 1906), 90 S. W. Rep. 1066: "When the State, by the general law enacted in 1903, provided for the consolidation of corporations in this State, the statute became, as it were, a part of the charter of the Central University, as if written therein originally. We do not mean to go further here than to decide the precise question presented, which is the power of the corporation to consolidate with another corporation having the same end to accomplish and using substantially the same means to accomplish it. So long as the consolidated corporation undertook to do the thing originally undertaken

by its constituents, we hold that the purpose of the original incorporators and of those whose means set the thing on foot was not being diverted. The only matter altered was the means by which it was to be accomplished. The statute provides: 'Any two or more corporations organized under this chapter or under the law of this state, may consolidate into a single corporation.' This power of consolidation is conferred in amplest terms. It is not confined to any class of corporations. . . . While parts of the section may be inapplicable, as where consent of a certain per cent of the stockholders is to be obtained where there are no stockholders, still the section clearly discloses that the course to be pursued is, after the assent of the respective corporations is obtained, that the articles of consolidation shall be executed by the directors or governing bodies of the corporations respectively."

<sup>3</sup> *Ante*, § 22: "What Railroads may consolidate — Statutory Provisions."

connecting line with their own, and the effect of such provisions is, manifestly, to limit the right of consolidation to that class of railroads. Accordingly, to bring railroad corporations within the provisions of such statutes it must be shown that there is such a physical connection between their roads as to permit the cars of one road to pass to the other, uninterruptedly, without the transshipment of passengers or freight.<sup>1</sup>

It is sufficient, however, that the connected roads form a continuous line, and it is not necessary that the road of one corporation should be an extension from either terminus of the other.<sup>2</sup>

Whether the required physical connection may be formed by means of leased lines has been the subject of extensive judicial consideration. The weight of authority supports the view that consolidation, under the statutes referred to, can take place only when the railroads *owned* by the corporations proposing to consolidate form continuous lines.<sup>3</sup> In constru-

<sup>1</sup> *Central R. Co. v. Macon*, 43 Ga. 646 (1871); *State v. Vanderbilt*, 37 Ohio St. 590 (1889); *State v. Atchison*, etc. R. Co., 24 Neb. 143 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164) (lease).

Under the Ohio statute it has been held that two non-parallel railroads may be deemed to "form a continuous line" when their tracks are connected, not directly but by those of a "union" terminal company. *Burke v. Cleveland*, etc. R. Co., 22 Wkly. Law Bull. (Ohio) 11 (1889).

Under the New York statute authorizing the consolidation of railroads forming a continuous line with each other or "by means of any intervening railroad bridge or ferry" two railroads connected by a railroad bridge owned by another corporation may be consolidated. "The statute contained no requirement that such intervening railroad bridge or ferry should be owned or operated by either of the consolidating companies and none such can be implied."

*New York Central*, etc. R. Co. v. City of Yonkers, 103 N. Y. Supp. 252, (1907, N. Y. Supreme Court).

<sup>2</sup> *Hancock v. Louisville*, etc. R. Co., 145 U. S. 409 (1892), (12 Sup. Ct. Rep. 969). See also *Wallace v. Long Island R. Co.*, 12 Hun (N. Y.) 460 (1877).

<sup>3</sup> *State v. Vanderbilt*, 37 Ohio St. 590 (1882). See also *East Line*, etc. R. Co. v. State, 75 Tex. 434 (1889), (12 S. W. Rep. 690); *State v. Atchison*, etc. R. Co., 24 Neb. 143 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164) (lease); *Smith v. Reading City Pass. R. Co.*, 13 Pa. Co. Ct. Rep. 49 (1893); *Hampe v. Mt. Oliver I. R. Co.*, 24 Pitts. Leg. J. (N.S.) 330 (1894) (lease).

*Contra*, *Black v. Delaware*, etc. R. Co., 22 N. J. Eq. 130 (1871), where the Chancellor held that where an act authorized a railroad company to lease to or consolidate with any other corporation whose works should form continuous or connecting lines with its own, a lease was authorized to a

ing a statute authorizing consolidation "when the lines of road of any railroad companies . . . admit the passage of burden or passenger cars over any two or more of such roads continuously, without break or interruption," the Supreme Court of Ohio in *State v. Vanderbilt*<sup>1</sup> said: "It is plain that the connection is formed and only exists by the lines of the lessors, and that as to the lessee companies there is no connection. . . . Plainly, as it seems to us, there is no consolidation of the lessor companies; and it is equally clear that the right to consolidate, based on the consolidating company's ownership of the leased roads, is wholly untenable."

Statutes authorizing the consolidation of connecting lines do not establish exceptions to statutory provisions against the consolidation of parallel and competing railroads. The lines of two railroad companies which are, in their general features, parallel and competing cannot be connected for the carriage

railroad company whose lines were connected by an intervening road. In so holding, the Chancellor said that the works of the United Companies formed both connected and continuous lines with the works of the Pennsylvania Railroad Company; that two railroads form a continuous line when their tracks and rails join, so that a train may pass from the rails and tracks of one directly upon those of the other—they form a connected line when this is done by means of an intervening or connecting road. This doctrine was, however, doubted by the Supreme Court of New Jersey when the case came to that Court (24 N. J. Eq. 455 (1873)): "If it is held that the lease may be made with any road in or out of the State, with which the united companies are connected by means of an intervening road or canal, they may unite with almost any road in the whole country, and it may be with roads abroad if they were connected by means of steamships. There should be a very clear expression of power so extensive and extraordinary as this."

See also *Hervey v. Illinois Midland Co.*, 28 Fed. 172 (1884) (case of sale), where the Court said: "It is quite true that the Peoria, Atlanta & Decatur Railroad Company was not authorized to purchase any railroad in the State; but I incline to think that its charter authorized the purchase of any road which, from its location, would be fairly deemed a continuation of the main line of the purchasing company. The effect of the agreement between the three companies was to establish a continuous line from Peoria, via Decatur to Terre Haute. That small parts of that line were and are owned by other companies, does not affect the substance of the transaction whereby, with the knowledge and approval of the great body of the bondholders and stockholders of the three roads, they were operated as one line, under a common management." Also *Cleveland, etc. R. Co. v. Erie*, 27 Pa. St. 380 (1856).

<sup>1</sup> *State v. Vanderbilt*, 37 Ohio St. 590 (1882).

of freight and passengers over both "continuously"; and hence such companies cannot become consolidated into one corporation under the Ohio statute above referred to.<sup>1</sup>

Under another Ohio statute authorizing the consolidation of domestic railroad corporations owning roads running to the boundary line of the State, with similar corporations of an adjoining State, owning roads forming a continuous line therewith, it was held that an Ohio, an Indiana, and an *Illinois* corporation might consolidate so as to form a *de facto* consolidated corporation upon the principle that the last two companies *might* have been consolidated and have become an Indiana corporation — a corporation of an adjoining State to that of the Ohio company — with which it might have consolidated.<sup>2</sup>

<sup>1</sup> *State v. Vanderbilt*, 37 Ohio St. 590 (1882): "The Cleveland, Cincinnati and Indianapolis Ry. and the Cincinnati, Hamilton and Dayton R. R., with their leased lines, constitute two great arteries of trade, both commencing on the Ohio River at Cincinnati, meeting at Dayton, and extending thence to Lake Erie, one terminating at Cleveland and the other at Toledo. The Attorney-General says, and the record supports the statement, that these roads are 'for sixty miles lying parallel and near to each other.' That they are, indeed, in the largest sense, parallel and competing roads, seems to be beyond dispute, and it may be fairly inferred from the record that a leading object in making the consolidation was to destroy that competition. That being true, the lines of these roads are not, in my judgment, 'so constructed as to admit the passage of burden or passenger cars over two or more of such roads continuously,' within the proper meaning of section 3379. That the mere physical ability to pass cars from one road to the other satisfies the statute, is a construction which is wholly inadmissible, for the provision requiring such con-

nection would be without meaning. In imposing that restriction upon consolidation, the legislature intended, not merely that the physical fact should exist, but that such consolidation should only be made for the very passing of freight and passengers over both lines, or some material parts thereof, not necessarily in a direct or straight line, but continuously."

See also *Hafer v. Cincinnati, etc. R. Co.*, 29 Wkly. Law Bull. (Ohio) 68 (1896), 4 S. & C. P. (Ohio) 487.

<sup>2</sup> *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 653 (1897). The Court said: "It cannot be denied, however, that under the Illinois statute, the Illinois and Indiana corporations might have united, and that then the consolidated corporation, being a corporation of Indiana, could be consolidated with the Ohio corporation; and we should have had just what the corporation under consideration purports to be, to wit: a legally consolidated corporation of Ohio, Indiana, and Illinois. It is obvious that, if such a corporation could have been legally formed, the mere mistake in the mode by which the union was brought about (if it was a mistake, which I do not decide)

It is not necessary in order to bring railroad companies within the provisions of statutes authorizing the consolidation of continuous or connecting lines that their lines should be entirely constructed if, when constructed, they will form continuous or connecting lines.<sup>1</sup>

The legal principles governing, and cases illustrating, the consolidation of connecting lines are equally applicable to the purchase or lease of such lines.

§ 30. **Construction of Statutes authorizing Consolidation of Corporations other than Railroads.** — Statutes authorizing the consolidation of mining, manufacturing and business corporations, generally, have already been briefly reviewed.<sup>2</sup> These statutes, as a rule, are limited in their application to corporations engaged in business of a similar nature and, sometimes, to those carrying on business in the same locality. Under such a statute authorizing the consolidation of corporations of the same nature covering the same territory it was held that two water companies organized for the purpose of supplying water to the same village might lawfully consolidate.<sup>3</sup>

It has been said, however, that a consolidation act permitting the amalgamation of "two business or manufacturing companies" whose "objects and business are of the same nature" does not apply to or include corporations endowed with peculiar and exclusive franchises and privileges.<sup>4</sup> It

does not prevent the corporation from being a *de facto* corporation, under the principles stated at length above."

<sup>1</sup> *Livingston County v. Portsmouth First Nat. Bank*, 128 U. S. 102 (1888), (9 Sup. Ct. Rep. 18): "The statute applied to the consolidation, although no road had yet been constructed." See also *Washburn v. Cass County*, 3 Dill. (U. S.) 251 (1875). Compare, however, *Clarke v. Omaha, etc. R. Co.*, 4 Neb. 459 (1876), where a general corporation law of Nebraska which gave no power to consolidate "until the roads shall have been constructed" was under consideration. See also *Venner v. Atchison, etc. R. Co.*, 28 Fed. 585 (1886).

<sup>2</sup> *Ante*, § 23: "*What Corporations other than Railroads may consolidate — Statutory Provisions.*"

<sup>3</sup> *Cameron v. New York, etc. Water Co.*, 62 Hun (N. Y.) 269 (1891), *affirmed* in 133 N. Y. 336 (1892), (31 N. E. Rep. 104).

For construction of Pennsylvania act of 1901 authorizing the merging of certain corporations, and corporate purchases of stock, see *Motter v. Kennett Tp. Electric Co.* 212 Pa. St. 613 (1905), (62 Atl. Rep. 104).

<sup>4</sup> *New Orleans Gas Light Co. v. Louisiana Light, etc. Co.*, 11 Fed. 277 (1882).

was also held that the same statute did not permit the consolidation of two companies the life of one of which was to terminate at the commencement of the life of the other.<sup>1</sup> The business of a gas company and that of an electric light company are of the same general character within the meaning of a statute authorizing the consolidation of corporations of the same or a similar nature.<sup>2</sup> An electric light company is a "manufacturing corporation" within the meaning of an act providing that "two or more mining, quarrying or manufacturing corporations may unite and amalgamate."<sup>3</sup>

A consolidation effected under a statute authorizing the amalgamation of "any two corporations . . . whose objects and business are, in general, of the same nature," is not rendered invalid by the fact that one of the consolidating corporations was itself the result of a previous consolidation.<sup>4</sup>

<sup>1</sup> *New Orleans Gas Light Co. v. Louisiana Light, etc. Co.*, 11 Fed. 277 (1882).

<sup>2</sup> *People v. Rice*, 138 N. Y. 151 (1893), (33 N. E. Rep. 846).

A corporation organized under laws for the incorporation of benevolent, charitable, scientific and missionary, but not religious, societies is not a corporation of the same nature as a religious corporation, nor of a similar nature, and cannot consolidate with such corporation under the New York statute referred to in the text. *Selkir v. Klein*, 100 N. Y. Supp. 449 (1906), (50 Misc. Rep. 194).

<sup>3</sup> *Beggs v. Ed. El. Light, etc. Co.*, 96 Ala. 295 (1891), (11 So. Rep. 381; 38 Am. St. Rep. 94). An electric light company has also been held to be a "manufacturing" corporation within the meaning of a taxation statute. *People v. Wemple*, 129 N. Y. 543 (1892), (29 N. E. Rep. 808; 14 L. R. A. 708). Precisely the opposite was, however, held in *Commonwealth v. Northern El. Light, etc. Co.*, 145 Pa. St. 105 (1891), (22 Atl. Rep. 839).

<sup>4</sup> *Jones v. Missouri Edison Electric Co.*, 135 Fed. 153 (1905), *reversed* on other points 144 Fed. 765 (1906).

## CHAPTER III

## CONSTITUTIONAL AND STATUTORY RESTRAINTS UPON CONSOLIDATION

- § 31. Public Policy regarding Consolidation of Competing Railroads.
- § 32. Constitutional and Statutory Provisions against Consolidation of Competing Railroads.
- § 33. Construction of Prohibitions — (A) Meaning of Term "Consolidation."
- § 34. Construction of Prohibitions — (B) Whether a Lease amounts to Consolidation.
- § 35. Construction of Prohibitions — (C) Arrangements amounting to Consolidation.
- § 36. Construction of Prohibitions — (D) Control of Competing Railroads by Holding Corporation.
- § 37. Construction of Prohibitions — (E) What are Competing or Parallel Railroads.
- § 38. Prohibition of Consolidation of Competing Railroads not a Regulation of Interstate Commerce.
- § 39. Constitutional Prohibitions against Consolidation of Competing Carrier Corporations other than Railroads.
- § 40. Enforcement of Provisions against Consolidation of Competing Lines.

§ 31. **Public Policy regarding Consolidation of Competing Railroads.** — It may be a serious economic question whether the consolidation of competing railroad companies works, in the end, injury to the public. The increased capital may result in bringing the roads to a higher standing of efficacy; the resulting economies in operation may permit the lowering of rates; the possibility of disastrous rate wars is eliminated. On the other hand, consolidation *may* produce an increase in rates, public facilities are placed in the hands of a single corporation relieved from the obligations imposed by competition, and rate wars do not always result disastrously to the *public*.

Whatever may be the merits of the question, however, it is not an open one from the popular point of view.<sup>1</sup> Public

<sup>1</sup> *Pearsall v. Great Northern R. Co.*, 161 U. S. 646, 676 (1896), (16 Sup. Ct. Rep. 705): "Whether the consolidation of competing lines will necessarily result in an increase of rates, or whether such consolidation has gener-

ally resulted in a detriment to the public, is beside the question. Whether it has that effect or not, it certainly puts it in the power of the consolidated corporation to give it that effect; in short, puts the public at



policy, as has been shown, favors the consolidation of connecting railroads for the purpose of establishing the through line, but is opposed to the consolidation of railroads which are naturally competitors for the business of the same territory.<sup>1</sup>

the mercy of the corporation. There is and has been, for the past three hundred years, both in England and in this country, a popular prejudice against monopolies in general, which has found expression in innumerable acts of legislation. We cannot say that such prejudice is not well founded. It is a matter upon which the legislature is entitled to pass judgment. At least there is sufficient doubt of the propriety of such monopolies to authorize the legislature, which may be presumed to represent the views of the public, to say that it will not tolerate them unless the power to establish them be conferred by clear and explicit language. While, in particular cases, two railroads, by consolidating their interests under a single management, may have been able to so far reduce the expenses of administration as to give their customers the benefit of a lower tariff, the logical effect of all monopolies is an increase of price of the thing produced, whether it be merchandise or transportation. Owing to the greater speed and cheapness of the service performed by them, railways become necessarily monopolists of all traffic along their lines, but the general sentiment of the public declares that such monopolies must be limited to the necessities of the case, and rebels against an attempt of one road to control all traffic between terminal points, also connected by a competing line. There are, moreover, thought to be other dangers to the moral sense of the community, incident to such great aggregation of wealth which, though indirect, are even more insidious in their influence, and such as have awakened feelings

of hostility which have not failed to find expression in legislative acts."

<sup>1</sup> *State v. Vanderbilt*, 37 Ohio St. 590 (1882): "The policy of the country in general, indicated in constitutional and statutory provisions, has long been opposed to the consolidation of roads bearing such relation to each other [competing and parallel], and this strengthens the belief that these companies are not within the section in question. Consolidation for the transportation of freight and passengers continuously is a thing which the legislature might well desire to encourage, as it may be advantageous alike to the public and the companies; but corporations have power only as granted by the general assembly, and where companies situated as these are, being parallel and competing, claim that authority to consolidate has been granted to them, they must be able to point to words in the statute which admit of no other reasonable construction, for it will not be assumed that the lawmaking power has authorized the creation of a monopoly so detrimental to the public interests." See also *Woodruff v. Erie R. Co.*, 93 N. Y. 615 (1883); *State v. Atchison, etc. R. Co.*, 24 Neb. 143 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164); *Central R., etc. Co. v. Collins*, 40 Ga. 582 (1869).

Another view as to the propriety of such legislation was, however, expressed by Lord Hatherley, then Vice Chancellor Wood, in *Hare v. Railway Co.*, 2 Johns. & H. 80 (1861): "I see nothing in the alleged injury to the public arising from the prevention of competition. . . . It is a mistaken notion that the public is benefited

In many States statutes have been enacted prohibiting the consolidation of competing or parallel lines, and in others the people have inserted such provisions in their fundamental laws. Other States indicate the same policy by failing to authorize consolidation at all.

Public sentiment, as so crystallized in statutes and constitutional provisions, is not of recent inception. As said by Mr. Justice Brown in *Louisville, etc. R. Co. v. Kentucky*:<sup>1</sup> "This restriction upon the unlimited power to consolidate with other roads is not, as the plaintiff in error suggests, called for by any new view of commercial policy, but by virtue of a settled policy which has obtained in Kentucky since 1858, in Minnesota since 1874, in Ohio since 1851, in New Hampshire since 1867, and by more recent enactments in some dozen other States — a policy which has not only found place in the statute law of such States as apprehended evil effects from such consolidations, but has been declared by the courts to be necessary to protect the public from the establishment of monopolies. Indeed the unanimity with which the States have legislated against the consolidation of competing lines shows that it is not the result of local prejudice, but of a general sentiment, that such monopolies are reprehensible."

§ 32. **Constitutional and Statutory Provisions against Consolidation of Competing Railroads.** — Public policy as directed against the consolidation of competing railroad companies has manifested itself in the constitutional provisions and statutes printed or referred to in the footnote.<sup>2</sup> These con-

by putting two railway companies against each other till one is ruined, the result being at last to raise the fares to the highest possible standard."

<sup>1</sup> *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 698 (1896), (16 Sup. Ct. Rep. 714).

<sup>2</sup> *Arkansas*. Const. Art XVII. § 4: "No railroad, canal, or other corporation, or the lessees, purchasers, or managers of any railroad, canal, or other corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or

purchase the works or franchises of, or in any way control, any other railroad or canal corporation owning or having under its control a parallel or competing line, nor shall any officer of such railroad or canal corporation act as an officer of any other railroad or canal corporation owning or having control of a parallel or competing line; and the question whether railroads or canals are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil issues."

stitutional provisions, as will be observed, generally embrace other carrier corporations as well as railroad companies.

*Colorado.* Const. XV. § 5: "No railroad corporation, or the lessees or managers thereof, shall consolidate its stock, property, or franchises with any other railroad corporation owning or having under its control a parallel or competing line."

*Georgia.* Const. Art. IV. § 2, par. 4: "The General Assembly of this State shall have no power to authorize any corporation to buy shares or stock in any other corporation in this State or elsewhere, or to make any contract or agreement whatever with any such corporation which may have the effect to defeat or lessen competition in their respective businesses, or to encourage monopoly; and all such contracts and agreements shall be illegal and void."

*Illinois.* Const. Art. XI. § 11: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place, except upon public notice given of at least sixty days, to all stockholders, in such manner as may be provided by law. A majority of the directors of any railroad corporation, now incorporated or hereafter to be incorporated by the laws of this State, shall be citizens and residents of this State."

*Kentucky.* Const. § 201: "No railroad, telegraph, telephone, bridge, or common carrier company shall consolidate its capital stock, franchises, or property, or pool its earnings, in whole or in part, with any other railroad, telegraph, telephone, bridge, or common carrier company owning a parallel or competing line or structure, or acquire by purchase, lease, or otherwise, any parallel or competing line or structure, or operate the same."

*Michigan.* Const. Art. XIX. A,

§ 2: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place except upon public notice of at least sixty days given to all stockholders, in such manner as shall be provided by law."

*Missouri.* Const. Art. XII. § 17: "No railroad or other corporation, or the lessees, purchasers, or managers of any railroad corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control, any railroad corporation owning or having under its control a parallel or competing line; nor shall any officer of such railroad corporation act as an officer of any other railroad corporation owning or having the control of a parallel or competing line. The question whether railroads are parallel or competing lines shall, when demanded, be decided by a jury, as in other civil issues."

*Montana.* Const. Art. XV. § 6: "No railroad corporation, express or other transportation company, or the lessees or managers thereof, shall consolidate its stock, property, or franchises with any other railroad corporation, express or other transportation company, owning or having under its control a parallel or competing line; neither shall it in any manner unite its business or earnings with the business or earnings of any other railroad corporation; nor shall any officer of such railroad, express or other transportation company, act as an officer of any other railroad, express or other transportation company, owning or having control of a parallel or competing line."

In Colorado, Illinois, Kentucky, Michigan, Missouri, Montana, Nebraska, North Dakota, Pennsylvania, South Carolina,

*Nebraska.* Const. Art. XI. § 3: "No railroad corporation or telegraph company shall consolidate its stock, property, franchises, or earnings, in whole or in part, with any other railroad corporation or telegraph company owning a parallel or competing line; and in no case shall any consolidation take place, except upon public notice of at least sixty days to all stockholders, in such manner as may be provided by law."

*North Dakota.* Const. Art. VII. § 141: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place except upon public notice given at least sixty days to all stockholders, in such manner as may be provided by law. Any attempt to evade the provisions of this section by any railroad corporation, by lease or otherwise, shall work a forfeiture of its charter."

*Pennsylvania.* Const. Art. XVII. § 4: "No railroad, canal, or other corporation, or the lessees, purchasers, or managers of any railroad or canal corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad or canal corporation owning or having under its control a parallel or competing line; nor shall any officer of such railroad or canal corporation act as an officer of any other railroad or canal corporation owning or having the control of a parallel or competing line; and the question whether railroads or canals are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil issues."

*South Carolina.* Const. Art. IX. § 7: "No railroad or other transportation company, and no telegraph or other transmitting company, or the lessees, purchasers, or managers of such corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad or other transportation company owning or having under its control a parallel or competing line; and the question whether railroads or other transportation, telegraph, or other transmitting companies are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil causes."

*South Dakota.* Const. Art. XVII. § 14: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a parallel or competing line; and in no case shall any consolidation take place except upon public notice given out, at least sixty days, to all stockholders in such manner as may be provided by law. Any attempt to evade the provisions of this section by any railroad corporation, by lease or otherwise, shall work a forfeiture of its charter."

*Texas.* Const. Art. X. § 5: "No railroad or other corporation, or the lessees, purchasers, or managers of any railroad corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any railroad corporation owning or having under its control a parallel or competing line; nor shall any officer of such railroad corporation act as an officer of any other railroad corporation owning or having the

South Dakota, Texas, and West Virginia, the constitutional inhibition is against the consolidation of "competing or parallel lines." In Utah and Washington "competing" lines only are referred to.

Consolidation with a corporation "owning" a competing line is prohibited in Illinois, Kentucky, Michigan, Nebraska, North Dakota, South Dakota, Utah, Washington, and West Virginia, while in the constitutions of Missouri, Montana, Pennsylvania, South Carolina, and Texas the similar provision reads, "owning or having under its control" such line.

In Georgia and Wyoming all contracts to prevent competition are prohibited and Texas does not permit consolidation with foreign railroad corporations at all.

control of a parallel or competing line."

Art. X. § 6. "No railroad company organized under the laws of this State shall consolidate by private or judicial sale or otherwise with any railroad company organized under the laws of any other State or of the United States."

*Utah.* Const. Art. XII. § 13: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a competing line."

*Washington.* Const. Art. XII. § 16: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad corporation owning a competing line."

*West Virginia.* Const. Art. XI. § 11: "No railroad corporation shall consolidate its stock, property, or franchises with any other railroad owning a parallel or competing line, or obtain the possession or control of such parallel or competing line, by lease or other contract, without the permission of the legislature."

*Wyoming.* Const. Art. X. § 8: "There shall be no consolidation or combination of corporations of any kind whatever to prevent competition, to control or influence produc-

tions or prices thereof, or in any manner to interfere with the public good or general welfare."

In contradistinction to the phrase "continuous or connecting lines" consolidation statutes, generally, employ the phrase "parallel or competing lines" — authorizing the consolidation of the one and prohibiting the consolidation of the other. Provisions prohibiting the consolidation of parallel or competing railroads appear in the statutes of the following States, some of which also, as will be observed, have similar constitutional provisions: Arkansas, Arizona, Connecticut, Florida, Idaho, Maryland, Minnesota, Mississippi, Missouri, Montana, New York, South Carolina, Tennessee, Utah, Washington, West Virginia, Wisconsin. For references to consolidation statutes see note, *ante*, § 22: "*What Railroads may consolidate — Statutory Provisions.*"

In Florida (Acts 1887, p. 117), and New York (R. R. Laws, § 80, see *ante*, § 22, note), the railroad commissioners may authorize the consolidation of competing lines. For Minnesota statutes see *post*, § 35, note.

The constitutions of Arkansas, Missouri, Montana, and Pennsylvania prohibit the officers of railroad companies from becoming officers in competing corporations. In Arkansas, Missouri, and Pennsylvania the question whether railroads are parallel or competing lines, is to be determined by the jury as in other civil issues.

The constitutions of North Dakota and South Dakota provide that any attempt by any railroad corporation to evade their provisions against consolidation shall work a forfeiture of its charter.

The West Virginia constitution prohibits the consolidation of competing or parallel lines "*without the permission of the legislature.*" As no consolidation is possible without legislative sanction this provision is, and was doubtless intended to be, wholly ineffective.

Statutory provisions against the consolidation of competing railroads have no *ex post facto* application.<sup>1</sup>

§ 33. **Construction of Prohibitions — (A) Meaning of Term "Consolidation."** — Constitutional and statutory provisions against the consolidation of competing lines of railroad are not penal in their nature, but are declaratory of the policy of the State in favor of the preservation of competition and are entitled to a liberal construction. The purpose of constitutional conventions in adopting such provisions and of legislatures in enacting such laws was to place an effective bar against any union of railroad companies whereby competition might be removed.<sup>2</sup>

While, therefore, the term "consolidation" is generally used to describe a union of corporate properties and stock-

<sup>1</sup> Manchester, etc. R. Co. v. Concord R. Co., 66 N. H. 131 (1889), (20 Atl. Rep. 383, 49 Am. St. Rep. 582, 9 L. R. A. 689).

<sup>2</sup> Manchester, etc. R. Co. v. Concord R. Co., 66 N. H. 131 (1889), (20 Atl. Rep. 383, 49 Am. St. Rep. 582, 9 L. R. A. 689): "The purpose of the legislature was to make the act in question an effective instrumentality against the consolidation of competing roads through contracts

or arrangements between them by means of which competition is removed." See also State v. Atchison, etc. R. Co., 24 Neb. 143 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164); East St. Louis, etc. R. Co. v. Jarvis, 92 Fed. 743 (1899); Morrill v. Railroad Co., 55 N. H. 531 (1875); Gulf, etc. R. Co. v. State, 72 Tex. 404 (1888), (10 S. W. Rep. 81, 13 Am. St. Rep. 815, 1 L. R. A. 849).

holders by the process of absorption or fusion, it has a broader meaning as used in constitutional and statutory provisions against the consolidation of competing railroads, and is here used in the sense of "join" or "unite."<sup>1</sup>

In *East St. Louis, etc. R. Co. v. Jarvis*,<sup>2</sup> Judge Jenkins said: "It is contended that the term 'consolidation' means a permanent union of the interests, management, and control of two roads, either in the formation of a new company out of the consolidated one, or else by consolidated management of the old ones unitedly while their distinct corporate entities still remained. This distinction is true in the general sense in which one speaks of the 'consolidation' of railroads. The term may also mean the act of forming into a more firm or compact mass, body, or system. The constitutional convention, representing the people of the State, sought to provide against monopolies, and to preserve to the public the benefit that would accrue from competition between parallel or competing lines of railway. It sought for practical results. It intended to provide that parallel or competing lines should continue to be competing, and this it aimed to accomplish by prohibiting the consolidation of the stock or the franchises or the property of any such competing lines of railway. The union of such lines was prohibited, in view of the objects sought to be accomplished. The term 'consolidate' we think must be construed to have been used in the sense of 'join' or 'unite.' To permit two such competing lines of railway under a single management and a single control would accomplish the very purpose which the constitution sought to prevent. We must have regard to the spirit and the object of that constitutional provision, and not juggle with the technical meaning of the word. The pro-

<sup>1</sup> In *State v. Atchison, etc. R. Co.*, 24 Neb. 164 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164), the Supreme Court of Nebraska said: "This [the constitutional provision] is an absolute prohibition against a railroad corporation consolidating its stock, property, franchises, or earnings, in whole or in part, with any other corporation owning a parallel or competing line. The word 'consolidate'

is here used in the sense of join or unite. The constitutional convention aimed at practical results."

Power to join or unite, however, does not authorize consolidation. *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 684 (1896), (16 Sup. Ct. Rep. 714).

<sup>2</sup> *East St. Louis, etc. R. Co. v. Jarvis*, 92 Fed. 743 (1899).

hibition goes to the consolidation or uniting of the stock of two competing roads, or of the franchises of two competing roads, or of the property of two competing roads. The doing of either would create the prohibited monopoly, and either is within the intendment and meaning of the constitutional provision."

§ 34. **Construction of Prohibitions — (B) Whether a Lease amounts to Consolidation.** — It has been held that a *lease* of a competing railroad falls within a constitutional provision against the consolidation of competing lines.<sup>1</sup> The courts in so holding have based their conclusion upon the premise — indicated in the last section — that the term "consolidate" is broadly used in such inhibitions in the sense of "join" or "unite."

It may be doubted, however, whether the conclusion follows from the premise. In order to make the constitutional provisions effective instruments for the accomplishment of the purposes for which they were designed, a liberal construction is necessary and proper, and the word "consolidate" may well

<sup>1</sup> *State v. Atchison, etc. R. Co.*, 24 Neb. 164 (1888), (8 Am. St. Rep. 164, 38 N. W. Rep. 43): "The constitutional convention aimed at practical results. The character of the title of the parties operating a railway is of but little moment to the general public, while the requirement that different roads shall continue to be competing lines, as when they were constructed, is of the utmost importance to all. The law cannot be evaded, therefore, by substituting a lease for a deed of conveyance."

This decision was rendered upon demurrer. Compare decision upon the merits, 38 Neb. 437 (1893), (57 N. W. Rep. 20).

*East St. Louis, etc. R. Co. v. Jarvis*, 92 Fed. 743 (1899): "Nor do we think that there is force in the contention that this union or consolidation was by means of a temporary arrangement, if thereby that is accomplished which is prohibited by the constitution. If it be lawful,

by means of a lease for ten years, to consolidate and unite the properties of competing lines of railway, we perceive no reason why a lease for ninety-nine years would not be equally valid. We cannot draw the line in that respect between what is permanent and what is temporary. Whatever produces the prohibited result is obnoxious to the spirit and the letter of the constitutional provision, and is illegal. We must deal with the result accomplished, without regard to the means employed. It cannot be permitted that one may effect a prohibited result by indirection which he may not lawfully accomplish by direct means. We must therefore hold that the leases in question practically effected a consolidation of the properties of two competing lines, and are within the inhibition of the constitution."

Compare *Missouri Pacific R. Co. v. Owens*, 1 Tex. App. Civ. Cas. § 384 (1883).



be described as an equivalent for "join" or "unite." But these terms when applied to corporations would seem to imply some legal union or joinder — something more than the mere physical conjunction of corporate properties effected under a lease.

Constitutional provisions often expressly prohibit the leasing of competing roads, but, in the absence of such a prohibition, a construction which reads it into a constitutional provision by virtue of the use of the word "consolidate" is — to say the least — strained.<sup>1</sup>

§ 35. **Construction of Prohibitions — (C) Arrangements amounting to Consolidation.** — An arrangement whereby one railroad company, in return for a guaranty of its bonds by a company owning a parallel and competing road, was to turn over one-half of its stock to the stockholders of the latter company, or to a trustee for their benefit, was held by the Supreme Court of the United States in *Pearsall v. Great Northern R. Co.*,<sup>2</sup> to constitute a clear violation of statutes prohibiting railroad companies from consolidating with, or in any way owning or controlling, other corporations having parallel or competing lines.<sup>3</sup> Mr. Justice Brown said: "The fact that

<sup>1</sup> In *Gere v. New York Central R. Co.*, 19 Abb. N. C. 210 (1885), the New York Supreme Court, in considering whether a lease came within the New York statute against the consolidation of competing lines, said: "The leasing of one railroad by another, whether for a longer or shorter period, is not a merger or consolidation. The term 'lease' implies the continued existence of the corporation, the lessor, with all its powers and functions, and all the rights incident to its creation, and it would be a gross misapplication of terms to hold that a leasing or contract for use by one railroad to another is a merger or consolidation of the two roads." Also *Wallace v. Long Island R. Co.*, 12 Hun (N. Y.), 460 (1877). A lease is not a consolidation within the meaning of the *Montana* constitutional provision. *State v. Mon-*

*tana R. Co.*, 21 Mont. 221 (1898), (53 Pac. Rep. 623; 45 L. R. A. 271n). See also *ante*, § 14: "*Distinction between Consolidation and Lease.*"

<sup>2</sup> *Pearsall v. Great Northern R. Co.*, 161 U. S. 671 (1896), (16 Sup. Ct. Rep. 705).

For consideration of the later attempted combination or practical consolidation of the Great Northern and Northern Pacific railways by means of a holding corporation see § 397a, *post*: "*The Northern Securities Case.*"

<sup>3</sup> *Minnesota. Laws 1874*, ch. 29 (Act of March 9, 1874): "No railroad corporation, or the lessees, purchasers, or managers of any railroad corporation, shall consolidate the stock, property, or franchises of such corporation with, or lease or purchase the works or franchises of, or in any way control any other railroad cor-

one-half of the capital stock of the reorganized company is to be turned over to the shareholders of the Great Northern, which is, in turn, to guarantee the payment of the reorganized bonds, is evidence of the most cogent character to show that nothing less than a purchase of a controlling interest, and practically the absolute control, of the Northern Pacific is contemplated by the arrangement. . . . There is, however, in addition to that, an alternative provision that the transfer may be made to a trustee for the use of the stockholders, who would, of course, act as their agent and represent them as a body, and, in fact, stand as the company under another name. Doubtless these stockholders could lawfully acquire by individual purchases a majority, or even the whole of the stock of the reorganized company, and thus possibly obtain its ultimate control; but the companies would still remain separate corporations with no interests, as such, in common. This, though possible, would not be altogether feasible and would require considerable time for its accomplishment. In a few years the two companies might, by sales of the stock so acquired, become completely dissevered, and the interests of the stockholders of each company thus become antagonistic. Under the proposed arrangement, however, the Northern Pacific as a company, in return for a guaranty, which the individual stockholders could not give, turns over to a trustee for the entire body of stockholders of the Great Northern one-half of its stock, with the almost certainty of the latter securing the complete control, and probably the ultimate amalgamation, of the two companies.”<sup>1</sup>

poration owning or having under his control a parallel or competing line; nor shall any officer of such railroad corporation act as the officer of any other railroad corporation owning or having the control of a parallel or competing line; and the question whether railroads are parallel or competing lines shall, when demanded by the party complainant, be decided by a jury as in other civil issues.”

Laws of 1881, ch. 94 (Act of March 3, 1881): “No railroad corporation shall consolidate with, lease or pur-

chase, or in any way become the owner of or control any other railroad corporation, or any stock, franchise, or rights of property thereof which owns or controls a parallel or competing line.”

<sup>1</sup> In *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368, it was held that the purchase by one corporation of a sufficient amount of the stock of another corporation, owning a parallel and competing road, to give control of the latter, was in contravention of the Pennsylvania

Where persons in charge of an insolvent construction company which had contracted to build a railroad for a corporation, and had received all its stock and other assets as security, without beginning the work, transferred the stock of the construction company to the managers of an operating railroad which would compete with the projected road if completed (the funds of the latter railroad being used for the purchase), it was held that the evident purpose of the transaction was to violate by indirection the provisions of the constitution of Georgia declaring the purchase of the stock of one corporation by another, and any contract between them tending to lessen competition, illegal and void.<sup>1</sup>

A prohibition against the consolidation of parallel or competing railroads cannot be evaded by a judicial sale. "If from reasons of public policy, the legislature declares that a railway shall not become the purchaser of a parallel or competing line, the purchase is not the less unlawful because the parties choose to let it take the form of a judicial sale."<sup>2</sup>

### § 36. Construction of Prohibitions — (D) Control of Com-

stitutional provision against the consolidation of corporations owning parallel or competing lines. See also *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 374.

Pooling contracts have been held invalid under a statute prohibiting consolidation. *Currier v. Concord R. Co.*, 48 N. H. 321 (1869); *Morrell v. Railroad Co.*, 55 N. H. 537 (1875); *Manchester, etc. R. Co. v. Concord R. Co.*, 66 N. H. 100 (1889), (20 Atl. Rep. 383, 9 L. R. A. 689, 49 Am. St. Rep. 582).

A traffic arrangement between parallel lines was held to be illegal in *Gulf, etc. R. Co. v. State*, 72 Tex. 404 (1888), (10 S. W. Rep. 8, 13 Am. St. Rep. 815, 1 L. R. A. 849). *Compare*, however, *People v. O'Brien*, 111 N. Y. 64 (1889), (18 N. E. Rep. 692).

<sup>1</sup> *Langdon v. Branch*, 37 Fed. 449 (1888), (2 L. R. A. 120). See also *Hamilton v. Savannah, etc. R. Co.*, 49 Fed. 415 (1892).

In *Dady v. Georgia, etc. R. Co.*,

112 Fed. 838 (1900), it was held, in construing the Georgia constitutional provision, that where separate lines of railway transport freight and passengers for widely separated sections of two States, and no point on either road can be reached in any reasonable time by a passenger starting out on the other, consolidation does not tend to defeat competition and create a monopoly merely because two shallow rivers, on which steamboats carrying freight and passengers occasionally ply, are crossed by both lines.

<sup>2</sup> *Louisville, etc. R. Co. v. Kentucky*. 161 U. S. 693 (1896), (16 Sup. Ct. Rep. 714). In this case it was held also that acquiescence by the State in several purchases by a railroad of local lines which ran parallel to some of its own branches could not be treated as a contemporaneous construction of its charter authorizing, generally, consolidation with parallel and competing roads.

**peting Railroads by Holding Corporation.** — The question whether the acquisition of control of competing railroad companies by a holding corporation, formed for the purpose, is in contravention of constitutional or statutory provisions against the consolidation of competing lines, has never been directly decided by the court of highest authority.<sup>1</sup>

The following preliminary propositions have, however, been established:

(1) Prohibitions against the consolidation of competing railroads are declaratory of public policy.<sup>2</sup>

(2) Practical as well as technical consolidation contravenes such provisions.<sup>3</sup>

(3) Between the State and the corporation, acts of the stockholders may be regarded as acts of the corporation.<sup>4</sup>

<sup>1</sup>The application of the State of Minnesota to the Supreme Court of the United States for leave to file an original bill for an injunction to restrain the alleged consolidation of two competing railroad companies by means of a holding corporation was denied because of the want of indispensable parties — only the holding corporation being named as defendant — which could not be brought in without defeating the constitutional jurisdiction of the court. *Minnesota v. Northern Securities Co.*, 184 U. S. 199 (1902), (22 Sup. Ct. Rep. 308).

The State of Washington then filed a similar application making the railroad corporations and the holding corporation defendants, and, after a hearing, the Supreme Court granted leave to file the bill. *Washington v. Northern Securities Co.* 185 U. S. 254 (1902), (22 Sup. Ct. Rep. 623). This case was subsequently dismissed per stipulation.

The State of Minnesota also filed a similar bill in a State court, which was removed to the Circuit Court of the United States, where Judge Lochren held that control by a holding corporation did not amount to a consolidation in violation of the

Minnesota statute against the consolidation of competing railroads (*Minnesota v. Northern Securities Co.*, 123 Fed. 692 (1903)). This decision was reversed by the Supreme Court upon the ground that the case had been improperly removed from the State Court. (194 U. S. 48 (1903), (24 Sup. Ct. Rep. 598)).

The decision under the federal statute is examined in another section of this treatise. See *post*, § 397a, "*The Northern Securities Case.*" In this connection it should be noted that the decision of Judge Lochren was rendered before that of the Supreme Court in this case.

<sup>2</sup> *Ante*, §§ 33, 34, 35.

<sup>3</sup> *Ante*, §§ 33, 34, 35.

<sup>4</sup> In *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33 n.), the Court of Appeals of New York said: "The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought, is itself a fiction, and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as

(4) Unity of ownership is distinguishable from community of interest.<sup>1</sup>

(5) Assuming that an individual stockholder has the right to sell his stock, it does not necessarily follow that a majority of stockholders may combine to sell their stock.<sup>2</sup>

Further, it has been held by the Supreme Court of the United States that an arrangement of this character is a combination in restraint of interstate commerce in violation of the federal anti-trust statute.<sup>3</sup>

The conclusion seems necessarily to follow that the control

permitted by the law; and the substantial inquiry always is what, in a given case, has been that collective action and agency. As between the corporation and those with whom it deals, the manner of its exercise is usually material; but as between it and the State, the substantial inquiry is only what that collective action and agency has done, what it has in fact accomplished, what is seen to be its effective work, what has been its conduct." See also *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145).

<sup>1</sup> The distinction between the ownership of controlling interests in competing railroad companies by individuals acting together in temporary harmony and the ownership of such interests by a single corporation is apparent, and is illustrated by the following language of Mr. Justice Brown in *Pearsall v. Great Northern R. Co.*, 161 U. S. 671 (1896), (16 Sup. Ct. Rep. 705): "Doubtless these stockholders could lawfully acquire by individual purchases a majority, or even the whole, of the stock of the reorganized company, and thus possibly obtain its ultimate control; but the companies would still remain separate corporations with no interests, as such, in common. This, though possible, would not be altogether feasible, and would require considerable time for its accomplish-

ment. In a few years the two companies might, by sales of the stock, so acquired, become completely dis-severed and the interests of the stockholders of each company thus become antagonistic."

<sup>2</sup> *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 373, 29 Am. & Eng. R. Cas. 145: "During the argument counsel invoked the aid of the undoubted general principle that the ownership of shares of stock carries with it the legal right to sell, and contended that the owners of the shares of the South Pennsylvania Railroad Company could not legally be restrained from so doing and that an injunction against the purchase would have this effect. We do not think the principle applies to this case. We are not called upon to express any opinion as to the right of individual shareholders to sell their several shares *bona fide* in the open market. This, so far as they are concerned, is an intended sale in combination, for the express purpose of enabling them to abandon the rights and duties conferred and imposed upon them by the act incorporating the company and of putting the control of their company in the hands of its rival. This is an act contrary to the public policy of the State, which they have no right to do."

<sup>3</sup> See *post*, § 397a, "*The Northern Securities Case.*"

of competing railroads by a holding corporation would amount to a practical consolidation, and would contravene the State statutory and constitutional prohibitions.

§ 37. **Construction of Prohibitions — (E) What are Competing or Parallel Railroads.** — To render railroads competing lines they must be substantial competitors for business. "The competition must be of some practical importance, such as is liable to have an appreciable effect on rates."<sup>1</sup> Thus two railroads which did not touch at any two common points and between which for a distance of forty miles another railroad ran, and the traffic of one of which except an unimportant amount would in no event pass over the other, were held not to be competing lines.<sup>2</sup>

"Parallel lines are not necessarily competing lines, as they not infrequently connect entirely different termini and command the traffic of distinct territories."<sup>3</sup> Passenger travel over parallel streets of cities is not necessarily competing travel.<sup>4</sup>

<sup>1</sup> *Kimball v. Atchison, etc. R. Co.*, 46 Fed. 888 (1891).

<sup>2</sup> *Kimball v. Atchison, etc. R. Co.*, 46 Fed. 888 (1891).

<sup>3</sup> *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 698 (1896), (16 Sup. Ct. Rep. 714), where the Supreme Court of the United States said: "For instance, a line from Toledo to Cincinnati is substantially parallel with another from Chicago to Cairo; but they could scarcely be called competing, since one is dependent upon the traffic of the Northwest, while Cincinnati is a southern outlet of the traffic of the Northeastern States and the lower lakes. Another familiar instance is that of the three north and south railways through the State of Connecticut, one from Bridgeport to Pittsfield, in Massachusetts, another from New Haven to Springfield, and another from Norwich to Worcester. These are strictly parallel lines, but in only a limited sense competing, since they are between different termini and each is required

for the trade of its own section of the State."

<sup>4</sup> In *Gyger v. Philadelphia, etc. R. Co.*, 136 Pa. St. 96 (1890), (20 Atl. Rep. 399), the Supreme Court of Pennsylvania said: "We think, also, that it is quite clear that the sense of 'competing,' which is the essential sense of the prohibition, is not applicable to the travel upon the streets of cities and towns over passenger railways. The competition of traffic between distant points, by rival roads and canals, tends to promote cheap transportation and thereby tends to the public good. But if this is prevented by the absorption of one of the competing lines by the other, the wholesome competition ceases and higher rates soon result. This is the evil which was sought to be prevented by the fourth section of the seven-teenth article. It will be seen at once that it is inapplicable to the travel upon the streets of cities and towns on passenger railways. The travel over parallel streets is not

Conversely, "competition between railroads may exist and yet their lines not run parallel, but cross each other at some point in their route."<sup>1</sup> Railroads having the same termini are competing lines although their roads are far apart and there is no pretension that they are parallel.<sup>2</sup> Two lines having but one common terminus may also be competing when one company has a traffic contract giving it the right to use a road running to the other terminus of the other road.<sup>3</sup> Competition *in fact* is what the constitutional and statutory provisions are designed to encourage, and for this reason it has been held that a railroad by its relations to other roads may be a competing line with a road with which it is not parallel and does not connect.<sup>4</sup>

The phrase "a parallel or competing line" includes a projected but not wholly constructed road if such road when completed and in operation would actually compete with the road seeking control. "Before completion it is 'parallel,' when completed it will become 'competing.'"<sup>5</sup>

The court may take judicial notice of the geography of the State, and the general direction of two railroads as fixed by their charters and can then determine whether they are par-

necessarily a competing travel. Each State has a travel of its own which is conducted upon its own railway. That travel may be almost entirely conducted without competition with the travel upon another, though parallel, street, nor do railways upon parallel streets have the same termini."

The *Texas* constitutional provision against the acquisition of railroads by parallel and competing lines does not apply to street railways. *Scott v. Farmers' etc. Bank* (Tex. 1903) 75 S. W. Rep. 7.

<sup>1</sup> *East Line, etc. R. Co. v. Rushing*, 69 Tex. 306 (1887), (6 S. W. Rep. 834); *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690); *Texas, etc. R. Co. v. Southern Pacific Co.*, 41 La. Ann. 970 (1889), (6 So. Rep. 888, 17 Am. St. Rep. 445); *East St. Louis,*

*etc. R. Co. v. Jarvis*, 92 Fed. 743 (1899).

<sup>2</sup> *Texas, etc. R. Co. v. Southern Pacific Co.*, 41 La. Ann. 970 (1889), (6 So. Rep. 888, 17 Am. St. Rep. 445).

<sup>3</sup> *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368, 29 Am. & Eng. R. Cas. 145. See also *State v. Vanderbilt*, 37 Ohio St. 590 (1882).

<sup>4</sup> *East Line, etc. R. Co. v. State* 75 Tex. 446 (1889), (12 S. W. Rep. 690): "We further concur with the court below in holding that railways by reasons of their relations with, control, or management of other lines than their own, may become, within the meaning of the law, competing lines, though the railroads owned by them may not in fact connect."

<sup>5</sup> *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368, 29 Am. & Eng. R. Cas. 145.

allel, but the existence of competition must be established by evidence as any other fact.<sup>1</sup>

§ 38. **Prohibition of Consolidation of Competing Railroads not Regulation of Interstate Commerce.** — As already shown, State statutes authorizing the consolidation of railroad corporations engaged in interstate commerce are not regulations of such commerce in violation of the federal constitution.<sup>2</sup> And the same conclusion follows with respect to legislation prohibiting the consolidation of competing railroads. Corporations created by the State derive the power to consolidate from the State alone. The State may withhold such power entirely, may accompany the grant of it with such limitations as it may choose to impose, and, under the police power, may take it away when granted if its operation may be prejudicial

<sup>1</sup> In *East Line, etc. R. Co. v. Rushing*, 69 Tex. 313 (1887), (6 S. W. Rep. 834), the Supreme Court of Texas said: "It may be that this court, judicially knowing the geography of the State, might take notice from the general direction of these two roads as fixed by the statutes under consideration, that their lines must necessarily cross each other, and could therefore treat them as connecting lines, and not parallel to each other. But as to whether they were competing lines we could have no judicial notice whatever. Competition between railroads may exist and yet their lines not run parallel, but cross each other at some point in their route. Hence when a question as to such competition is raised, the court or jury must have proof upon the subject, as in the case of any other fact submitted for its consideration."

*Compare*, however, *Gulf, etc. R. Co. v. State*, 72 Tex. 410 (1888), (10 S. W. Rep. 81, 13 Am. St. Rep. 815), where the same Court said: "Whether two roads which intersect each other at a certain point are competitors for freight or not, must depend upon a variety of circumstances not known to the court. But the

authorities cited show that we must take judicial notice of the geography of the State and at least of its navigable streams. It is a matter of history that important lines of railroad once established have remained as fixed and permanent in their course as the rivers themselves. They supersede in the main all other modes of travel between the points which they touch and become as well, if not better, known than any other geographical feature of the country. Their locality becomes 'notorious and indisputable.' . . . We think we must take judicial notice that these roads are parallel and competing lines. . . . We cannot shut our eyes to the 'notorious and indisputable' facts that these parts of the respective lines touch at the same points, and that they are natural competitors for the traffic of a large scope of country."

See also *Georgia Pac. R. Co. v. Gaines*, 88 Ala. 381 (1889), (7 So. Rep. 382).

<sup>2</sup> See *ante* § 19a: "*Authorization of Consolidation of Interstate Railroads not Regulation of Interstate Commerce.*"



to the public welfare. The exercise of the authority of the State, in any of these forms, involves no interference with interstate commerce, for it relates entirely to a State grant to a State corporation.<sup>1</sup>

The power of the State, however, to prohibit the consolidation of competing railroads is not exclusive. Congress may also prohibit such consolidations when in restraint of interstate commerce. And the power of Congress is dominant. A State consolidation act could never justify a consolidation of interstate railroads in violation of a federal statute.<sup>2</sup>

<sup>1</sup> In the leading case of *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 701 (1896), (16 Sup. Ct. Rep. 714), Mr. Justice Brown said: "While the constitutional power of the State in this particular has never been formally passed upon by this Court, the power of the State to impose this restriction upon the general authority to consolidate has been recognized in a number of cases. . . In the last case (*Ashley v. Ryan*, 153 U. S. 346 (1894)), (14 Sup. Ct. 865), it was broadly held that a State, in permitting railway companies to consolidate, might impose such conditions as it might deem proper, and that the acceptance of the franchise implied a submission to the conditions without which it could not have been obtained. The power to forbid such purchase or consolidation with competing lines has been directly upheld in a large number of cases in the State courts, in some of which cases a violation of the commerce clause was suggested and in others it was not. In conclusion we are of the opinion: that . . . section 201 of the Constitution of 1891 was a legitimate exercise of the police power of the State and forbade such consolidation."

See also *Northern Securities Co. v. United States* 193 U. S. 348 (1904).

<sup>2</sup> *Development of Commerce Clause of Constitution.*

A clear appreciation of the distinction between the exclusive and the dominant powers of Congress under the commerce clause of the Constitution requires a brief examination of its development in this respect.

President Monroe in a message to Congress said that nothing more was intended by the commerce clause than to prevent the imposition of duties by States upon goods brought in from other States. Moreover, the circumstances surrounding the adoption of the commerce clause support the view that the power was intended to be limited and, to a certain extent, concurrent with the powers of the States. The motive to give Congress the "sole and exclusive" power over commerce was lost in the Constitutional Convention. That the power of Congress was merely concurrent with that of the States and involved no prohibition of State action not inconsistent with Federal laws was, moreover, the opinion of the attorney-general immediately after the adoption of the Constitution (Opinion of Edmund Randolph, attorney-general, Feb. 12, 1791), and of different State courts.

It was acknowledged from the beginning that the power of Congress, when exercised, was paramount. The essential question was whether it was exclusive or concurrent. This question was first answered in *Gibbons*

§ 39. **Constitutional Prohibitions against Consolidation of Competing Carrier Corporations other than Railroads.** — Constitutional provisions against the consolidation of competing corporations do not apply to railroad companies alone. In proportion to their use by the public it is as essential that competition should be preserved in the case of other corporations of a *quasi*-public nature as in the case of railroad corporations.

Accordingly, constitutional provisions against the consolidation of competing lines, while nearly always applying to railroad companies, apply also — as the case may be — to telegraph,<sup>1</sup> telephone,<sup>2</sup> and “other transmitting companies,”<sup>3</sup> and to canal,<sup>4</sup> bridge,<sup>5</sup> express,<sup>6</sup> other “common carrier,”<sup>7</sup> and “other transportation companies,”<sup>8</sup> owning competing lines or structures. Other constitutional provisions prohibit

*v. Ogden*, 9 Wheat. (U. S.) 189 (1824), in which Chief Justice Marshall said that the federal commercial power was indivisible and, therefore, exclusive of a like power in a coordinate sovereignty. The underlying principle is, that the power to regulate being the power to restrain, the grant of power to regulate necessarily implies power to determine what shall remain unrestrained. Inaction by Congress is equivalent to an affirmative declaration that no action is desired. Accordingly, while the decision of *Gibbons v. Ogden* has not always been followed, it is now well settled by the Supreme Court of the United States that, with respect to all subjects national in character and admitting uniformity of regulation, the federal commercial power is not only paramount but exclusive.

The sale, exchange and transportation of commodities and the transportation of persons manifestly admit of uniform regulation, and are subject solely to the control of Congress. The States are without power to impose any burdens upon such commerce, or to interfere with it in any way. It is only in the case of local

matters — in matters which are rather auxiliary to commerce than a part of it — that the States have power to act in the absence of action by Congress. If the prohibition of the consolidation of competing railroads could be said to affect interstate commerce at all, it would only do so with respect to such a matter of a local nature. In this connection see opinion of Mr. Justice Harlan in the *Northern Securities Case*, 193 U. S. 342 (1904).

<sup>1</sup> *Alabama*, Const. Art. XIV. § 11; *Colorado*, Const. Art. XV. § 13; *Kentucky*, Const. § 201; *Nebraska*, Const. Art. XI. § 3; *Pennsylvania*, Const. Art. XVI. § 12; *South Carolina*, Const. Art. IX. § 7; *South Dakota*, Const. Art. XVI. § 11.

<sup>2</sup> *Kentucky*, Const. § 201.

<sup>3</sup> *South Carolina*, Const. Art. IX. § 7.

<sup>4</sup> *Pennsylvania*, Const. Art. XVII. § 4.

<sup>5</sup> *Kentucky*, Const. § 201.

<sup>6</sup> *Montana*, Const. Art. XV. § 6.

<sup>7</sup> *Kentucky*, Const. § 201.

<sup>8</sup> *Montana*, Const. Art. XV. § 6; *South Carolina*, Const. Art. IX. § 7.

the consolidation of "corporations of any kind whatever" for the purpose of preventing competition.<sup>1</sup>

The States generally have also enacted so-called "anti-trust" statutes directed against combinations tending to create monopolies which are fully considered in another part of this treatise.<sup>2</sup>

§ 40. **Enforcement of Provisions against Consolidation of Competing Lines.** — The consolidation of competing or parallel railroad companies in the face of a constitutional or statutory prohibition is unlawful, and, therefore, *ultra vires*, and may be restrained at the suit of any stockholder.<sup>3</sup>

Such a consolidation is also a cause of forfeiture of the charters of the consolidating companies which may be enforced by the State in *quo warranto* proceedings.<sup>4</sup> The State may also enjoin such a consolidation and have the proceedings declared void, upon the ground that they are unlawful and contrary to the declared policy of the State.<sup>5</sup>

<sup>1</sup> *Wyoming*, Const. Art. X. § 8. See also *Georgia*, Const. Art. IV. § 2.

<sup>2</sup> See subdiv. II. Art. III. Part V., "*State Anti-trust Statutes*."

<sup>3</sup> *Pearsall v. Great Northern R. Co.*, 161 U. S. 647 (1896), (16 Sup. Ct. Rep. 705); *Hafer v. Cincinnati, etc. R. Co.*, 29 Week. Law. Bul. 68 (Cin. 1893). See also *Clark v. Central R. Co.*, 50 Fed. 338 (1892); *Hamilton v. Savannah, etc. R. Co.*, 49 Fed. 412 (1892); *Kimball v. Atchison, etc. R. Co.*, 46 Fed. 888 (1891). Compare *Langdon v. Branch*, 37 Fed. 449 (1888).

In *Currier v. Concord R. Corp.*, 48 N. H. 321 (1869), it was held under the peculiar provisions of the New Hampshire act of 1867 (since repealed) that any citizen might sue to restrain the consolidation of competing railroads.

<sup>4</sup> *State v. Vanderbilt*, 37 Ohio St. 590 (1882); *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690); *State v. Atchison, etc. R. Co.*, 24 Neb. 143 (1888), (38 N. W. Rep. 43.) In the last case, however,

the court did not adjudge a forfeiture but declared the offending contract void.

<sup>5</sup> *Louisville, etc. R. Co., v. Kentucky*, 161 U. S. 677 (1896), (16 Sup. Ct. Rep. 714); *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368, 29 Am. & Eng. R. Cas. 145; *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 374; *Gulf, etc. R. Co. v. State*, 72 Tex. 404 (1888), (10 S. W. Rep. 81, 13 Am. St. Rep. 815, 1 L. R. A. 849 n.) In *People v. Boston, etc. R. Co.*, 12 Abb. N. C. 230 (1883) it was held that a proposed consolidation of four New York railroad companies was invalid because they were parallel within the meaning of the statute and because they did not form a continuous line; that an action by the attorney-general to annul the contract of consolidation was the proper remedy.

Where two street railway companies which operated roads that were to a certain extent parallel and competing consolidated, another railway company which did not contend that

## CHAPTER IV

## ASSENT OF STOCKHOLDERS

- § 41. Requisite Number of Stockholders — (A) Under Laws in Force at Organization of Consolidating Corporations.
- § 42. Requisite Number of Stockholders — (B) When Unanimous Consent is necessary.
- § 43. Requisite Number of Stockholders — (C) Under Enactments in Exercise of Reserved Power.
- § 44. Power of Legislature to compel Consolidation under its Reserved Power.
- § 45. Assent of Stockholders — How manifested. Acquiescence. Estoppel.
- § 46. Rights and Remedies of Dissenting Stockholders.
- § 47. Rights and Remedies of Dissenting Subscribers.
- § 48. Procedure in Stockholders' Actions.
- § 49. Laches of Stockholders.
- § 50. Can a Majority effect Consolidation upon giving Security to Dissenting Stockholders?
- § 51. The Right to condemn Stock.

§ 41. **Requisite Number of Stockholders — (A) Under Laws in Force at Organization of Consolidating Corporations.** — Consolidation directly affects the interests of each stockholder. He exchanges a larger interest in a smaller corporation for a smaller interest in a larger corporation. The corporate funds are embarked upon a new enterprise of wider scope. As will be shown, it is only when the rights of minority stockholders are constitutionally limited by legislation that consolidation can be effected without the unanimous consent of stockholders.<sup>1</sup>

A statement, however, that unanimous consent, *as a general rule*, is essential to consolidation would be misleading in a modern treatise. General consolidation statutes almost invariably prescribe a proportion of shareholders whose consent is necessary to effect consolidation.<sup>2</sup> These statutes will, usually, be found to antedate the organization of corporations

the line of the consolidated company was parallel to or competed with its own or that its business was injuriously affected by the consolidation was without interest to contest the validity of the consolidation.

Shreveport Traction Co. v. Kan-

sas City, etc. R. Co. (La. 1907), 44 So. Rep. 457.

<sup>1</sup> See next section.

<sup>2</sup> See *post*, § 52, "*Formal Statutory Requisites*," for abstract of statutes showing number of assenting shares required in different consolidation acts.

proposing to consolidate at the present time. The American railway corporation has not been distinguished for longevity.

Where, therefore, a general statute in force at the time when the stock of the consolidating corporations was subscribed for provides that the consolidation agreement may be ratified by the holders of a majority or greater proportion of the shares of each corporation, the consent of the prescribed majority is sufficient.<sup>1</sup> Subscribers to the capital stock of the corpora-

<sup>1</sup> *Nugent v. Supervisors*, 19 Wall. (U. S.) 249 (1873): "The general statute of the State authorized all railroad companies then organized, or thereafter to be organized, to consolidate their property and stock with each other, and with companies out of the State, whenever their lines connect with the lines of such companies out of the State. . . . Nor is this all. The special charter of the Kankakee and Illinois River Railroad Company contained in its eleventh section an express grant to the company of authority to unite or consolidate its railroad with any other railroad or railroads then constructed or that might thereafter be constructed within the State, or any other State, which might cross or intersect the same, or be built along the line thereof, upon such terms as might be mutually agreed upon between said company and any other company. It was therefore contemplated by the legislature, as it must have been by all the subscribers to the stock of the company, that precisely what has occurred might occur. Subscribers must be presumed to have known the law of the State and to have contracted in view of it. When the voters of the county of Putnam sanctioned a county subscription by their vote, and when the board of supervisors in pursuance of that section resolved to make the subscription, they were informed by the law of the State that a consolidation with another company might be made; that the stock they proposed to sub-

scribe might be converted into stock of the consolidated company, and that the liability they assumed might become owing to that company. With this knowledge and in view of such contingencies they made the contract."

In *Mayfield v. Alton Ry. Gas & Elec. Co.*, 198 Ill. 533 (1902), (65 N. E. Rep. 100), the Supreme Court of Illinois said: "Of course, statutes authorizing consolidation after subscriptions have been made cannot be held to compel a dissenting stockholder to transfer his subscription to the consolidated company, because to do so would impair the obligation of his contract. But if a statute already in existence to that effect enters into and becomes a part of his contract, then manifestly there is no impairment of his contract by requiring him to submit to the required majority vote for the consolidation."

See also *Wilson v. Salamanca*, 99 U. S. 499 (1878); *Mansfield, etc. R. Co., v. Brown*, 26 Ohio St. 224 (1875); *Sparrow v. Evansville, etc. R. Co.*, 7 Ind. 369 (1856); *Bish v. Johnson*, 21 Ind. 299 (1863).

A pledgee of stock which is assigned in blank but is not transferred to his name upon the books of the corporation is not a stockholder, and is not entitled to participate in consolidation proceedings.

*Cleveland City R. Co. v. First National Bank*, 68 Ohio St. 582 (1903), (67 N. E. Rep. 1075).

tions are presumed to know the laws of the State regarding consolidation, and to contract in view of them. The law enters into and forms a part of the contract.

*A fortiori* is this conclusion true where the charters of the corporations themselves contain provisions authorizing consolidation by a majority vote. Such provisions become a part of the contract between the stockholders and the corporation, and their unanimous consent is not essential to consolidation.<sup>1</sup>

Power to consolidate conferred in the laws under which a corporation is organized, without any provision as to the necessary number of assenting shares, may be exercised by "proper corporate action," viz. a majority vote of the stockholders.<sup>2</sup>

**§ 42. Requisite Number of Stockholders — (B) When Unanimous Consent is necessary.** — The principle upon which unani-

<sup>1</sup> *Fisher v. Evansville, etc. R. Co.*, 7 Ind. 407 (1856); *Hanna v. Cincinnati, etc. R. Co.*, 20 Ind. 30 (1863); *Bish v. Johnson*, 21 Ind. 299 (1863); *Sparrow v. Evansville, etc. R. Co.*, 7 Ind. 369 (1856); *Atchison, etc. R. Co. v. Phillips County*, 25 Kan. 261 (1881).

Where the articles of association of a company prohibited consolidation without the consent of a majority of the stockholders it was held that another provision allowing the articles to be amended by a vote of two-thirds of the executive committee and a majority of the trustees did not authorize an amendment changing the provision concerning the stockholders' consent to consolidation; that it only allowed amendments pertinent to the business and objects for which the association was organized. *Blatchford v. Ross*, 54 Barb. (N. Y.) 42 (1869), (5 Abb. Pr. 434).

<sup>2</sup> In *Dady v. Georgia, etc. R. Co.*, 112 Fed. 842 (1900), Judge Speer said: "There are several grounds upon which complainants insist that they are entitled to relief. The first is that it requires the unanimous con-

sent of the stockholders of the Georgia & Alabama Railway, before the complainants can be permitted to consolidate or merge that company with the Seaboard Air Line or the Florida Central & Peninsular." The judge then distinguished the case of *Alexander v. Railway Co.*, 108 Ga. 866 (1889), (33 S. E. Rep. 866), and continued: "In other words, the Supreme Court of the State seems carefully to distinguish a case like that before them and a case like that before this court; for here the Georgia & Alabama Railway is chartered under this general law, and the court adds that the provisions of the general railroad law are operative when that law constitutes the whole or a portion of the railroad charter. What, then, is 'proper corporate action,' for the purpose of merger and consolidation, when this is made the policy of the State by its statutory law? Corporate action, then, is the majority vote of the corporation."

For Georgia statute under consideration in this case, see *ante*, § 22: "*What Railroads may consolidate — Statutory Provisions.*"

mous consent may be essential to consolidation is the principle of the Dartmouth College case,<sup>1</sup> enlarged in its application by the long line of authorities since that famous decision, that the charter of a private corporation and the association of the corporators thereunder constitute executed contracts, between the corporation and the State and between the stockholders and the corporation, within the protection of the constitutional provision against laws impairing the obligations of contracts.<sup>2</sup> The legislature has no right, except by express reservation, to pass any amendment to the charter of a private corporation which makes any material or fundamental change therein, without the consent of all the stockholders. Where, therefore, a corporation, when created, is without authority to consolidate, either under its charter or general laws, a grant of authority to consolidate, except in the form of an enabling act, makes a change of a material and fundamental character in its charter. The exercise of the power conferred under such conditions requires the unanimous consent of the stockholders.<sup>3</sup>

<sup>1</sup> *Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 700 (1819).

<sup>2</sup> *Pennsylvania College Cases*, 13 Wall. (U. S.) 212 (1871); *Wilmington R. Co. v. Reid*, 13 Wall. (U. S.) 264 (1871); *Delaware R. R. Tax*, 18 Wall. (U. S.) 206 (1873). In *Pearsall v. Great Northern R. Co.*, 161 U. S. 660 (1896), (16 Sup. Ct. Rep. 705), the principle is discussed and earlier cases reviewed.

<sup>3</sup> *United States: Clearwater v. Meredith*, 1 Wall. 39 (1863); *Pearce v. Madison, etc. R. Co.*, 21 How. 441 (1858); *Earl v. Seattle, etc. R. Co.*, 56 Fed. 911 (1893); *Knoxville v. Knoxville, etc. R. Co.*, 22 Fed. 758 (1884).

To effect a consolidation of railroad companies subsisting under special charters not providing therefor, the consent of every stockholder must be given; and any one dissenting stockholder is entitled to an injunction against such consolidation. *Mowrey v. Indianapolis etc. R. Co.*, 4 Biss. 78 (1866).

*Illinois: Illinois, etc. R. Co. v.*

*Cook*, 29 Ill. 237 (1862). In *Sprague v. Illinois River R. Co.*, 19 Ill. 174 (1857), it was held that an amendment to a railroad charter which authorized the consolidation of the road to be built under it with any other intersecting road was not an alteration in the charter of a fundamental nature.

*Indiana: Fisher v. Evansville, etc. R. Co.*, 7 Ind. 407 (1856).

The relation between a railroad company and a stockholder is one of contract; and any legislative enactment authorizing a material change in the powers or purposes of the corporation, if acted upon by the corporation, is not binding upon the stockholder, without his consent. *McCray v. Junction R. Co.*, 9 Ind. 358 (1857).

*Kentucky: Botts v. Simpsonville, etc. Turnpike Road Co.*, 88 Ky. 54 (1888), (10 S. W. Rep. 134, 2 L. R. A. 594); *Louisville, etc. R. Co. v. Howard*, 15 Ky. L. Rep. 25.

In *Clearwater v. Meredith*,<sup>1</sup> Mr. Justice Davis said: "When any person takes stock in a railroad corporation, he has entered into a contract with the company that his interests shall be subject to the direction and control of the proper authorities of the corporation, to accomplish the object for which the company was organized. He does not agree that the improvement to which he subscribed should be changed in purpose and character, at the will and pleasure of a majority of the stockholders, so that new responsibilities, and, it may be, new hazards, are added to the original undertaking. He may be willing to embark in one enterprise, and unwilling to engage in another; to assist in building a short line of railway and averse to risking his money in one having a longer line of transit."

A statute declaring that "it shall be lawful" for corporations to consolidate is with reference to corporations formed before its passage merely an enabling act. It gives the consent of the State to consolidation when all the stockholders approve, but does not limit the rights of dissenting stockholders.<sup>2</sup>

*Michigan*: Tuttle v. Michigan Air Line Co., 35 Mich. 247 (1877).

*Mississippi*: New Orleans, etc. R. Co. v. Harris, 27 Miss. 517 (1854).

*New Jersey*: Kean v. Johnson, 9 N. J. Eq. 401 (1853); Black v. Delaware, etc. Canal Co., 24 N. J. Eq. 455 (1873).

*Ohio*: Mansfield, etc. R. Co. v. Brown, 26 Ohio St. 223 (1875); Chapman v. Mad River, etc. R. Co., 6 Ohio St. 119 (1856).

*Texas*: Gulf, etc. R. Co. v. Newell, 73 Tex. 334 (1889), (11 S. W. Rep. 342, 15 Am. St. Rep. 788).

*Vermont*: Stevens v. Rutland, etc. R. Co., 29 Vt. 545 (1857).

*Contra*: Lauman v. Lebanon Valley R. Co., 30 Pa. St. 42 (1858), (72 Am. Dec. 685), where it was held that consolidation might be effected without the unanimous consent of stockholders if security were given to minority dissenting stockholders. See *post*, § 50.

<sup>1</sup> *Clearwater v. Meredith*, 1 Wall. (U. S.) 40 (1863).

<sup>2</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 4 (1886): "The provision in that act that it should be lawful to lease or consolidate is merely a legislative authorization — a concession on the part of the legislature of the power to do that which could not lawfully be done without such authority. It is not an enactment that the directors may, without the consent of the stockholders of the company, lease, consolidate, or merge. Nor is it, in effect, an enactment that they may, with the consent of the majority of the stockholders, do so. But the statute is merely an enabling act — a law intended to give, once for all, a general legislative authority to lease, consolidate, or merge."

In *Clearwater v. Meredith*, 1 Wall. (U. S.) 39 (1863), the Supreme Court of the United States also said: "The act of the legislature of Indiana allowing railroad corporations to merge and consolidate their stock, was an enabling act — was permissive, not mandatory. It simply gave the con-



The passage of an amendment conferring power to consolidate upon a corporation, which it has not attempted and may never attempt to exercise, does not *per se* affect the rights of stockholders.<sup>1</sup>

It has been held that a purchaser of stock after a statute has been enacted authorizing consolidation is bound by it notwithstanding consolidation was not authorized at the time such stock was subscribed for. This decision was placed upon the ground that the right of a subscriber to object to an authorized consolidation is a mere personal privilege which does not pass upon the sale of his stock.<sup>2</sup> Upon principle, however, it would seem that such a right is a right of property and transferable. But — as will be shown — the purchaser might be bound if the statute were passed in the exercise of the reserved power.

sent of the legislature to whatever could lawfully be done, and which, without that consent, could not be done at all."

See also *Hamilton Mut. Ins. Co. v. Hobart*, 2 Gray (Mass.) 543 (1854); *Alexander v. Railway Co.*, 108 Ga. 866 (1899), (33 S. E. Rep. 866).

<sup>1</sup> *Fry v. Lexington, etc. R. Co.*, 2 Mete. (Ky.) 314 (1859).

<sup>2</sup> *Colgate v. United States Leather Co.* (N. J. Ch. 1907), 67 Atl. Rep. 661: "The precise point, viz.: whether there is any difference in status between a purchaser of shares before or after the grant of the power of consolidation to the company has not been authoritatively decided in this State. . . . The basis for the proper decision of the question will be reached when once we have precisely and correctly settled the legal origin and scope of the stockholders' right of objection. It originates, in my judgment, solely from the contract between the company, considered as a corporate entity, and the individual stockholder, and this being the sole contract affected by the powers to consolidate, these two parties — the company and the individual stockholder — are the only

parties directly interested, and each stockholder for himself alone deals with the company, and not with any or all of the other stockholders, in relation to his assent or dissent. Each is bound by his own action or failure to act and so far as relates to the mere exercise or existence of the right to object is not governed or controlled by the action of any other stockholder or of all the others together, even if that action be taken at a meeting of the corporate body. . . . The question now considered is, whether any consolidation at all on terms legally authorized can be made against the objection of a stockholder who purchased his shares, not before, but after the act authorizing consolidation. In my judgment, the right to consolidation is an equity or right of a purely personal character, belonging only to the persons who were members or shareholders before the power to consolidate was given. The argument that unless the shareholder can transfer this right of objection with his shares he is deprived of property begs the question at issue whether it is a property right."

In England, as there are no constitutional restraints upon Parliament, the consolidation of existing corporations may be authorized without the unanimous consent of their stockholders.

§ 43. **Requisite Number of Stockholders — (C) Under Enactments in Exercise of Reserved Power.** — After the decision in the Dartmouth College case, the States generally passed laws providing that all charters thereafter granted should be subject to amendment or repeal at the pleasure of the legislature and special provisions to the same effect have often been inserted in charters.

Under this reserved power the decisions are uniform that the legislature has the power to alter or repeal charters when necessary to protect the interests of the State or of the public, but there has been a conflict of judicial opinion as to the power of the legislature to alter charters for the mere purpose of changing the rights of the shareholders among themselves, as in the case of a grant of power to consolidate. On the one hand, it has been held that the legislature, under such a reservation, has the right to authorize a consolidation of corporations, which can be carried into effect notwithstanding the objection of a minority of the stockholders;<sup>1</sup> on the other

<sup>1</sup> *Market Street R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225): "Corporations cannot, without the consent of all their stockholders, consolidate with others, except when the power so to do is given by their charters or by a general statute existing at the date of incorporation, or in those cases where the right is reserved by constitutional or statutory provision to the legislature to alter or amend the charter."

See also *Hale v. Cheshire R. Co.*, 161 Mass. 443 (1894), (37 N. E. Rep. 307); *Durfee v. Old Colony R. Co.*, 87 Mass. 230 (1862); *Buffalo, etc. R. Co. v. Dudley*, 14 N. Y. 348 (1856).

In the *Pennsylvania College Cases*, 13 Wall. (U. S.) 213 (1871), the Supreme Court of the United States dis-

cussed at length the nature of corporate charters and the constitutional rights of the legislature in connection therewith. Regarding the exercise of reserved powers the Court said: "Cases often arise where the legislature, in granting an act of incorporation for a private purpose, either makes the duration of the charter conditional or reserves to the State the power to alter, modify, or repeal the same at pleasure. Where such a provision is incorporated in the charter it is clear that it qualifies the grant, and that the subsequent exercise of that reserve power cannot be regarded as an act within the prohibition of the Constitution. Such a power also, that is, the power to alter, modify, or repeal an act of incorporation, is frequently reserved to the

hand, it has been held that the legislature, under its reserved power to amend the charter of a corporation, cannot authorize a consolidation without the unanimous consent of the stockholders when the effect of the consolidation is to increase the liabilities of the stockholders or diminish the value of their stock;<sup>1</sup> and in New Jersey it has been broadly held that such a reservation is made by the State for its own benefit, is not intended to effect or change the rights of incorporators as between themselves, and does not authorize the State to empower one part of the stockholders, for their own benefit, at their option, to change their contract with the other part; that the power to alter or modify a charter is exercisable only with respect to the powers and franchises conferred in it.<sup>2</sup>

State by a general law applicable to all acts of incorporation, or to certain classes of the same, as the case may be, in which case it is equally clear that the power may be exercised whenever it appears that the act of incorporation is one which falls within the reservation and that the charter was granted subsequent to the passage of the general law, even though the charter contains no such condition nor any allusion to such a reservation. Reservation in such a charter, it is admitted, may be made, and it is also conceded that where they exist the exercise of the power reserved by a subsequent legislature does not impair the obligation of the contract created by the original act of incorporation. Subsequent legislation altering or modifying the provisions of such a charter, where there is no such reservation, is certainly unauthorized if it is prejudicial to the rights of the incorporators, and was passed without their assent, but the converse of the proposition is also true, that if the new provisions altering and modifying the charter were passed with the assent of the corporation and they were duly accepted by a corporate vote as amendments to the original charter they

cannot be regarded as impairing the obligation of the contract created by the original charter."

<sup>1</sup> *Botts v. Simpsonville, etc. Turnpike Road Co.*, 88 Ky. 54 (1888), (10 S. W. Rep. 134, 2 L. R. A. 594).

In *Kenosha, etc. R. Co. v. Marsh*, 17 Wis. 13 (1863), it was held that the legislature, under its reserved power, had no right to authorize a radical fundamental change in the character of an enterprise; but whether consolidation worked such change *quære*. See also *Mowrey v. Indianapolis R. Co.*, 4 Biss. (U. S.) 78 (1866).

<sup>2</sup> *Zabriskie v. Hackensack R. Co.*, 18 N. J. Eq. 178 (1867), (90 Am. Dec. 617); *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 468 (1873).

In *Colgate v. U. S. Leather Co.* (N. J. Ch. 1907), 67 Atl. Rep. 657, it was held that a purchaser of stock in a corporation who acquired his stock after power to consolidate had been conferred upon the corporation could not object to its consolidation with another corporation upon the ground that the corporation did not possess the power to consolidate when organized — that the only persons who could object upon that ground were those who were stockholders

The weight of authority is, however, opposed to the latter conclusion and is in favor of the proposition that the legislature, under its reserved power, has the right to authorize consolidation without the unanimous consent of stockholders; that the legislature and the majority are not both subordinate to the will of a dissenting minority. The stockholders in joining the corporation are deemed to take their shares subject to the possibility of alteration by the legislature.<sup>1</sup>

**§ 44. Power of Legislature to compel Consolidation under its Reserved Power.** — While the weight of authority supports the view that the legislature, in the exercise of its reserved power, may *authorize* the consolidation of corporations by the action of a majority of their stockholders, its right to *compel* their consolidation against the will of a majority presents a very different question.

“Each and every shareholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation.”<sup>2</sup> This is a fundamental principle, and the legislature, while it may waive the public rights, has no more authority to divest the stockholders of a private corporation of their vested rights, based upon this principle, and compel them to become adventurers in a new enterprise than it has to force individuals to form a corporation.<sup>3</sup> For these

when the power to consolidate was conferred.

<sup>1</sup> *Hale v. Cheshire R. Co.*, 161 Mass. 443 (1894), (37 N. E. Rep. 307); *Market St. R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225).

<sup>2</sup> *Dudley v. Kentucky High School*, 9 Bush, 578 (1873). Also *Durfee v. Old Colony, etc. R. Co.*, 5 Allen (Mass.), 242 (1862).

<sup>3</sup> In *City of Knoxville v. Knoxville, etc. R. Co.*, 22 Fed. Rep. 763 (1884), Judge Baxter said: “But it was not competent for the legislature to do more in this respect than to waive the public rights. It could not divest or impair the rights of the shareholders, as between themselves, as guaranteed by the company’s charter, without their consent. It

was upon the faith of the stipulations contained in said charter that the shareholders subscribed to the capital stock, and thereby made themselves members of the corporation. These stipulations, as we have already seen, contemplated and provided for the construction of a railroad between the *termini* named, to be governed by the shareholders, in the manner and upon the terms prescribed. Each corporator is entitled to have the contract fairly interpreted and honestly enforced. The charter invests the owners of a majority of the capital stock with the right to control the corporate business within the scope of its provisions. Within this limit the power of a majority, when acting in good faith, is supreme.”

reasons it is clear that the legislature cannot compel the consolidation of corporations owning no public duties.<sup>1</sup>

On the other hand, the legislature may compel the consolidation of municipal and other essentially public corporations, including, as held by the Supreme Court of the United States, educational institutions.<sup>2</sup>

It has not, however, been directly decided that the compul-

<sup>1</sup> *Mason v. Finch*, 28 Mich. 282 (1873).

<sup>2</sup> *Pennsylvania College Cases*, 13 Wall. (U. S.) 214 (1871): "Apply those principles to the case under consideration, and it is quite clear that the decision of the State court was correct, as the fifth section of the charter, by necessary implication, reserves to the State the power to alter, modify, or amend the charter without any prescribed limitation. Provision is there made that the constitution of the college shall not be altered or alterable by any ordinance or law of the trustees, 'nor in any other manner than by an act of the legislature of the Commonwealth,' which is in all respects equivalent to an express reservation to the State to make any alteration in the charter which the legislature in its wisdom may deem fit, just, and expedient to enact, and the donors of the institution are as much bound by that provision as the trustees."

*McKee v. Chautauqua Assembly*, 130 Fed. 539 (1904): "The reserved power authorizes the legislature to make any alteration or amendment of a charter which will not defeat or substantially impair the object of the grant, or any rights vested under it, and which the legislature may deem necessary to promote the original purpose contemplated by its charter or articles of association, or to protect the rights of the public. The changes of more doubtful validity are those made by section 3. The provisions of this section not only merge the corporation with two others,

and thus embark it in new enterprises, but they compel it to assume the debts and liabilities of the corporations. Thus apparently these provisions appropriate the funds of the corporation, and divert them from its own treasury, to the extent necessary to pay the outstanding liabilities and carry on the operations of the other two corporations. If it were really the effect of these provisions to compel the corporation to embark its money improperly in one or more unrelated and independent concerns, the legislation would seem to be an unwarranted exercise of the power of alteration or amendment. . . . It appears, however, that for several years previous to the passage of the act that the three corporations had been practically one, and the power of management had been submitted to the Chautauqua Assembly. . . . Presumably the membership of the three corporations was composed of the same persons; but, however the fact may have been, it is not material; it suffices that no person had a voice in the control of the two corporations except the members of the Chautauqua Assembly. In view of this relation between the three corporations, the validity of the legislation is not fairly open to question. The provisions of section 3 were merely a legislative recognition and approval of the existing relations between them."

See also *Central University v. Walter* (Ky. 1906), 90 S. W. Rep. 1066.

sory consolidation of railroad companies and other *quasi*-public corporations is legal, nor does it appear that such legislation has ever been attempted.<sup>1</sup> Upon principle it seems that the reasoning applicable to distinctly private corporations applies to them. They are private corporations owing public duties. The State may hold them strictly to the performance of those duties and, for public reasons, may take away existing rights to consolidate.<sup>2</sup> It would seem that the converse of the proposition must necessarily follow, that the State cannot, itself, change the nature of the duties and the ability of the corporation to perform them by compelling consolidation.

§ 45. Assent of Stockholders — How manifested. Acquiescence. Estoppel. — While the assent of a stockholder to a proposed consolidation should regularly be expressed by his vote at a stockholders' meeting or by his approval in writing — as the consolidation act may provide — he cannot, after acquiescing in a consolidation and after the new corporation has taken charge of the property of the constituent corporations, attack the validity of the consolidation on the ground that he did not assent thereto. A stockholder who takes an active part in a consolidation estops himself from alleging his want of consent and, in the absence of fraud, from raising future objections.<sup>3</sup> A stockholder who consents to a con-

<sup>1</sup> The question is raised in *Mowrey v. Indianapolis, etc. R. Co.*, 4 Biss. (U. S.) 78 (1866).

In an early case in Connecticut (*Bishop v. Brainard*, 28 Conn. 289) (1859), it was said that the legislature, under its reserved power of amending a charter, might effect a consolidation of corporations by its direct action without any action upon the part of the stockholders or directors of the corporation. It appeared, however, that the directors and a *majority* of the stockholders had voted to ratify the consolidation so that the remarks of the court were *dicta* and the decision should rather be considered as holding that *antecedent* action by stockholders is not

essential to consolidation than as holding that the legislature, even in the exercise of its reserved power, can compel corporations to consolidate against the will of a majority of their stockholders.

<sup>2</sup> *Gibbs v. Consolidated Gas Co.*, 130 U. S. 407 (1889), (9 Sup. Ct. Rep. 553), where it was held that the legislature by a compulsory amendment to the charter of a gas company might prohibit the exercise of an existing right to consolidate with any other gas company. See also *ante*, §§ 24, 25, 26.

<sup>3</sup> *Glymont Imp., etc. Co. v. Toler*, 80 Md. 278 (1894), (30 Atl. Rep. 651); *Branch v. Atlantic, etc. R. Co.*, 3 Wood (U. S.), 481 (1879); *Boston*,

solidation is also estopped from questioning the regularity of the steps leading up to it. Thus, where an unauthorized amendment was accepted and adopted by the directory of a corporation, on the faith of which a consolidation was made, under legislative sanction, with another corporation, stockholders consenting to the consolidation were held to be estopped to dispute the validity of the amendment.<sup>1</sup> Where, however, an amendment did not, on its face, give the power to consolidate, a stockholder was held not to be estopped by his failure to object to it in season.<sup>2</sup> The merely preliminary vote of a director in favor of consolidation will not preclude him from subsequently objecting as a stockholder.<sup>3</sup>

etc. R. Co. v. New York, etc. R. Co., 13 R. I. 265 (1881) (sale); *Phinizy v. Augusta, etc. R. Co.*, 62 Fed. 684 (1894). See also *Drake v. New York Sub. Water Co.*, 50 N. Y. Supp. 826 (1898).

A person subscribing for the stock of a consolidated corporation thereby consents to the consolidation. *Fisher v. Evansville, etc. R. Co.*, 7 Ind. 470 (1856), (65 Am. Dec. 745).

Where a stockholder in a consolidating corporation participated in all the proceedings incident to consolidation and permitted the corporation so formed to control the corporate business and property, and third persons to purchase the mortgage bonds of the new company, and to acquire other rights and interests based on its lawful existence, the fact that at a foreclosure sale under the mortgage bonds issued by the *de facto* company, he notified purchasers that he would contest the consolidation, does not prevent him from being estopped to attack such consolidation. *Bradford v. Frankfort, etc. R. Co.*, 142 Ind. 383 (1895), (40 N. E. Rep. 741), (41 N. E. Rep. 819).

<sup>1</sup> *Deaderick v. Wilson*, 8 Baxt. (Tenn.) 108 (1874).

<sup>2</sup> *International, etc. R. Co. v. Bremond*, 53 Tex. 96 (1880): "Nor had

he, by failing to object to a subsequent enlargement of the charter, which, whether it actually gave such power or not, did not on its face purport to give any power to consolidate, precluded himself from objecting to a consolidation making so fundamental a change in the objects of the corporation. . . . A stockholder may be estopped by his conduct from objecting to a consolidation which was attempted without authority; but in its present case the conduct and action of Bremond have not . . . been such as to preclude him from still refusing to go into the new enterprise, or for demanding full compensation for his interest in the old."

<sup>3</sup> If a member of the board of directors of a corporation is present at the adoption of a resolution, and is aware of what is going on and makes no objection to its adoption, he must be presumed to have assented to it. But if such proceeding is merely preliminary to a subsequent vote of the stockholders on the consolidation of the corporation with another, which can ultimately be decided by the stockholders only, he will not be estopped from afterwards objecting as a stockholder. *Mowrey v. Indianapolis, etc. R. Co.*, 4 Biss. (U. S.) 78 (1866).

As the stockholders act in their individual capacities in adopting the consolidation agreement, it is immaterial that the directors of the consolidating corporations may have been directors of both corporations.<sup>1</sup>

§ 46. **Rights and Remedies of Dissenting Stockholders.** — When the unanimous consent of the stockholders is essential to consolidation, a dissenting stockholder is entitled to an injunction restraining a proposed consolidation on the ground that the funds of the corporation are being diverted to objects not authorized by its charter.<sup>2</sup> On the other hand, where a statute authorizes consolidation through the action of a prescribed majority of the stockholders and a consolidation is duly and in good faith effected in accordance with its provisions, a dissenting stockholder has no ground of complaint.<sup>3</sup>

"The right to recover . . . [the value of his stock] . . . upon the consummation of a consolidation may exist where the consolidation is effected without authority, or wrongfully, and without the consent of the suing stockholder, or where

Where the directors of two consolidating corporations provided in the consolidation agreement that unadjusted matters should be arranged according to a preliminary memorandum of agreement signed by a majority of the stockholders of the corporations, — the memorandum being thereby made a part of the consolidation agreement, — it was *held* that directors signing the agreement assented as stockholders to the memorandum and were bound by its provisions. *Cleveland City R. Co. v. First Nat. Bank*, 68 Ohio St. 582 (1903), (67 N. E. Rep. 1075).

<sup>1</sup> *Colgate v. U. S. Leather Co.* (N. J. 1907), 67 Atl. Rep. 657. And see *Hill v. Nisbet*, 100 Ind. 341 (1884). Compare, however, *Munson v. Syracuse, etc. R. Co.*, 103 N. Y. 73 (1886), (8 N. E. Rep. 355).

<sup>2</sup> *Clearwater v. Meredith*, 1 Wall. (U. S.) 40 (1863): "Clearwater could have prevented this consolidation had he chose to do so; instead of that he gave his assent to it and

merged his own stock in the new adventure. If a majority of the stockholders of the corporation of which he was a member had undertaken to transfer his interest against his wish, they would have been enjoined. There was no power to force him to join the new corporation, and to receive stock in it on surrender of his stock in the old company."

See also *Blatchford v. Ross*, 54 Barb. (N. Y.) 42 (1869); *Botts v. Simpsonville, etc. Turnpike Road Co.*, 88 Ky. 54 (1888), (10 S. W. Rep. 134, 2 L. R. A. 594); *Mowrey v. Indianapolis, etc. R. Co.*, 4 Biss. (U. S.) 78 (1866); *Zabriskie v. Hackensack, etc. R. Co.*, 18 N. J. Eq. 178 (1867), (90 Am. Dec. 617); *Stevens v. Rutland, etc. R. Co.*, 29 Vt. 545 (1857); *Young v. Rondout, etc. Gas Light Co.*, 129 N. Y. 57 (1891), (29 N. E. Rep. 83).

<sup>3</sup> *Jones v. Missouri Edison Elec. Co.*, 144 Fed. 765 (1906).



the right to consolidate is granted after such stockholder has subscribed for his stock.”<sup>1</sup>

A dissenting stockholder has a right of action in equity against the consolidated corporation, in the case of an unauthorized consolidation, upon the theory of a wrongful appropriation by it of his equitable interest in the original corporation.<sup>2</sup>

Where an unlawful consolidation has been brought about by the action of the stockholders, a dissenting stockholder cannot maintain an action for damages against the directors.<sup>3</sup>

While a dissenting stockholder may enjoin an unauthorized

<sup>1</sup> *Mayfield v. Alton Ry. Gas & El. Co.*, 100 Ill. App. 614 (1901), *affirmed*, 198 Ill. 528 (1902), (65 N. E. Rep. 100).

In this case a going corporation was absorbed by a new company with double the amount of capital stock but with nothing paid in except the assets of the company absorbed. The stockholders of the old corporation received share for share in the stock of the new corporation. It was *held* that this transaction did not amount to a confiscation of one-half the value of the stock in the old corporation in the absence of proof that the unissued stock of the new corporation had not been in good faith subscribed for.

In Pennsylvania where the peculiar doctrine prevails (see *post*, § 50) that even in the absence of a statute authorizing such procedure a majority may effect consolidation upon giving security to minority interests, it is held that a stockholder in a corporation who has voted against its consolidation with another company may bring a bill in equity to enforce payment of the value of his stock and is not obliged to resort to a statute providing for the appraisal of stock in aid of consolidation. *Barnett v. Philadelphia Market Co.*, 218 Pa. 649 (1907), (67 Atl. Rep. 912).

<sup>2</sup> A stockholder in a railway company, which, against his protest, has been consolidated with another company, by the action of other stockholders, and whose equitable interest has been wrongfully appropriated by the consolidated company, cannot maintain an action for the injury against the directors of the company as such; nor are directors responsible for a consolidation effected by stockholders. He, however, has an equitable action against the consolidated company for the wrongful appropriation of his interest. *International, etc. R. Co. v. Bremond*, 53 Tex. 96 (1880).

A stockholder in a constituent corporation who has not converted his stock into the stock of the consolidated company has no standing to maintain a stockholder's bill against that company. *Philadelphia, etc. R. Co. v. Catawissa R. Co.*, 53 Pa. St. 20 (1866).

A stockholder in a building association which has illegally absorbed another similar association cannot obtain relief which would be granted only to stockholders of the latter association. *Continental Building, etc. Ass'n. v. Miller*, 44 Fla. 757 (1902), (33 So. Rep. 404).

<sup>3</sup> *International, etc. R. Co. v. Bremond*, 53 Tex. 96 (1880).

consolidation, one of the constituent corporations itself cannot, after agreeing to a consolidation, object to its validity upon the ground that all its stockholders did not assent thereto.<sup>1</sup>

Where a statute provides that a consolidation shall not be effected without the payment of the value of the interests of stockholders who dissent, and a consolidation agreement is proposed which deprives a stockholder of this right, he is not bound to be present at the stockholders' meeting where such agreement is proposed to oppose it. He can stand upon his statutory rights and recover the value of his stock.<sup>2</sup>

It has been held that a purchaser of stock after a statute has been enacted authorizing consolidation cannot object to a consolidation upon the ground that it was not authorized at the time when such stock was subscribed for.<sup>3</sup>

§ 47. **Rights and Remedies of Dissenting Subscribers.** — Where authority to consolidate does not exist at the time when a corporation is chartered and where power to amend or repeal is not reserved, a grant of authority to consolidate works a change of a fundamental nature in the charter of a corporation and, it is held, exonerates dissenting subscribers for the stock of the corporation from further liability upon their subscriptions.<sup>4</sup> Mr. Justice Strong, in *Nugent v. Super-*

<sup>1</sup> *St. Louis, etc. R. Co. v. Terre Haute R. Co.*, 33 Fed. 440 (1888).

<sup>2</sup> *Douglass v. Concord, etc. R. Co.*, 72 N. H. 26 (1903), (54 Atl. Rep. 883): "As it is the law of this State that the union of two railroad corporations cannot be effected without the payment of the value of their interests to those who do not assent, and as the legislative authorization for the action proposed to be taken expressly provided for such payment as an essential to the validity of such contract, she was not legally bound to attend the meeting to oppose a contract illegally depriving her of her stock."

In this case the stockholder was permitted to recover her proportionate share of the stock of the consolidated corporation.

<sup>3</sup> *Colgate v. United States Leather Co.* (N. J. 1907), 67 Atl. Rep. 661. For consideration of this case see *ante*, § 42: "*Requisite Number of Stockholders* — (B) *When Unanimous Consent is Necessary*."

<sup>4</sup> *United States v. Nugent v. Supervisors*, 19 Wall. 248 (1873); *Clearwater v. Meredith*, 1 Wall. 25 (1863).

*Indiana*: *Shelbyville, etc. Turnpike Co. v. Barnes*, 42 Ind. 498 (1873); *Booe v. Junction R. Co.*, 10 Ind. 93 (1857); *McCray v. Junction R. Co.*, 9 Ind. 358 (1857); *State v. Bailey*, 16 Ind. 46 (1861), (79 Am. Dec. 405). *Mississippi*: *New Orleans, etc. R. Co. v. Harris*, 27 Miss. 517 (1854).

*North Carolina*: *Charlotte First Nat. Bank v. Charlotte*, 85 N. C. 433 (1881), (39 Am. Rep. 708).

visors,<sup>1</sup> thus stated the reason for the rule: "It must be conceded, as a general rule, that a subscriber to the stock of a railroad company is released from obligation to pay his subscription by a fundamental alteration of the charter. The reason of the rule is evident. A subscription is always presumed to have been made in view of the main design of the corporation, and of the arrangements made for its accomplishment. A radical change in the organization or purposes of the company may, therefore, take away the motive which induced the subscription, as well as affect injuriously the consideration of the contract. For this reason it is held that such a change exonerates a subscriber from liability for his subscription; or, if the contract has been executed, justifies a stockholder in resorting to a court of equity to restrain the company from applying the funds of the original organization to any project not contemplated by it."

A subscriber is, however, entitled to the benefit of his contract as made and is neither obliged to withdraw from it nor to embark in a new venture.<sup>2</sup>

This rule that the unconstitutional grant of authority to consolidate operates as a dissolution of the subscription contract and as a release of dissenting subscribers, is supported by the highest authorities. It is difficult, however, to justify it upon legal principles. An act unconstitutional as to a dissenting subscriber would seem to be void as to him. To say that it dissolves the subscription contract is to give effect to a void act. The distinction drawn between the position of a stockholder and that of a subscriber — treating the latter as a party to an executory contract only — is inaccurate. The effect of an ordinary subscription is, immediately, to constitute the

*England*: Dougan's Case, 28 L. T. Rep. 60 (1873).

<sup>1</sup> *Nugent v. Supervisors*, 19 Wall. 248 (1873).

<sup>2</sup> "The stockholders in the old corporation, who do not enter into the new corporation, are, therefore, in the absence of such statutes, entitled to withdraw from the venture and cease to be liable on their stock subscriptions. But in the absence of a

statute existing at the time of his subscription, providing for the consolidation upon a vote less than the whole, or for the purchase of the interests of dissenting stockholders in the event of a consolidation, it is conceived that he will neither be bound to consent to the consolidation nor to surrender his interest in his original corporation." 1 *Thomp. on Corp.* § 343.

subscriber a stockholder, subject to the liability to pay his subscription when called. Only a contract to subscribe for stock at a future time can properly be called an executory contract.

The general rule stated is inapplicable in a case where it is apparent from the articles of association that consolidation was one of the purposes for which the corporation was organized and that the consolidation in question is only carrying out that purpose. Consolidation, under such conditions, does not discharge a subscriber from the payment of his subscription, although authority to consolidate was granted after the subscription.<sup>1</sup>

§ 48. **Procedure in Stockholders' Actions.** — When a majority has taken steps towards an unauthorized consolidation or when unanimous consent is necessary, a dissenting stockholder may file a bill for an injunction and it is not necessary that he should first seek relief through the corporation. In *Nathan v. Tompkins*<sup>2</sup> the Supreme Court of Alabama said: "When the injury is to the shareholder individually, or there is a real contest between him and the corporation growing out of the acts of a majority of the stockholders in convention, and in excess of their powers, express or implied, he may maintain a suit to prevent the wrong without the vain and useless ceremony of attempting to induce the same majority to sue themselves. A dissenting stockholder may, under such circumstances, enjoin an unauthorized consolidation."

The stockholder is protecting his *own rights*, and it is immaterial whether he is acting in good faith for the interests of the corporation.<sup>3</sup> The injunction is granted to restrain the officers and managers of the corporation from diverting its funds, but it is necessary to make the corporation a party defendant.<sup>4</sup> An injunction once issued restraining an attempted consolidation will not be dissolved unless it is established by proof that the consolidation agreement has been

<sup>1</sup> *Hanna v. Cincinnati, etc. R. Co.*, 20 Ind. 30 (1863).

<sup>3</sup> *Central R. Co. v. Collins*, 40 Ga. 617 (1861).

<sup>2</sup> *Nathan v. Tompkins*, 82 Ala. 437 (1891), (2 So. Rep. 747). *Contra*, however, *Mozley v. Alston*, 1 Phil. Ch. 790 (1847).

<sup>4</sup> *Ridgway Township v. Griswold*, 1 McCrary (U. S.), 151 (1878).

cancelled. Allegations that the scheme has been abandoned are not sufficient.<sup>1</sup>

An injunction against an attempted consolidation will not be dissolved upon an answer which fails to allege the consent of the plaintiff, where the unanimous consent of the stockholders is essential to consolidation.<sup>2</sup>

§ 49. **Laches of Stockholders.** — Laches in bringing suit will preclude a dissenting stockholder from enjoining a consolidation. He cannot look to equity, but must content himself with some other form of remedy.<sup>3</sup> Reasonable haste is,

<sup>1</sup> *Nathan v. Tompkins*, 82 Ala. 446 (1886), (2 So. Rep. 747): "The answers do not aver that the resolutions have been rescinded, or any attempt made to rescind them, or any official declaration of the abandonment. The resolutions remain in force on the minutes, so far as the majority could impart vitality. In view of the character of the resolutions, — that the consolidation 'do now take place,' and be fully carried into effect, — a secret, uncommunicated intention to abandon, resting in the minds of the majority as individuals, does not meet the requirements of equity."

In *Blatchford v. Ross*, 54 Barb. (N. Y.) 42 (1869), it was held that an injunction restraining the consummation of the consolidation of two corporations would not be extended to prevent the use by the consolidated company of property delivered before the injunction was applied for, but would be continued to prevent the delivery of any more property and the taking of any steps to enforce consolidation upon unwilling stockholders.

<sup>2</sup> *Botts v. Simpsonville, etc. Turnpike Road Co.*, 88 Ky. 54 (1888), (10 S. W. Rep. 134, 2 L. R. A. 594).

<sup>3</sup> *Chapman v. Mad River, etc. R. Co.*, 6 Ohio St. 120 (1856); *International, etc. R. Co. v. Bremond*, 53 Tex. 96 (1880).

In *Beling v. American Tobacco Co.* (N. J. 1907), 65 Atl. Rep. 725, where, after a consolidation had been effected, the consolidated corporation carried on the business of the constituent companies, sold and exchanged some of their assets and commingled the proceeds with other funds it was held that a stockholder in a constituent corporation who made no objection for six months while the business was carried on and whose assignee had received notice of the meeting at which the merger agreement was acted upon, was not entitled to a decree in equity vacating the merger agreement. The Court said (p. 729): "The complainant argues with great force that the negligence or laches of his predecessor in title cannot, upon any legal or equitable principles, be extended so far as to forfeit his rights. Granting the general proposition to be as claimed by him, yet the complete answer is that the refusal to grant his decree does not work any forfeiture of his rights, but simply has its weight, in connection with other circumstances, in debarring him from the special and extraordinary relief which he is asking."

In *Dana v. American Tobacco* (N. J. 1907), 65 Atl. Rep. 730, the court held another stockholder who complained of the same consolidation as in the *Beling case, supra*, also guilty of laches on account of some

however, sufficient.<sup>1</sup> Acquiescence for an extended period, during which time the interests of third persons have intervened, may itself constitute laches and prevent a stockholder from attacking a consolidation even on the ground of fraud.<sup>2</sup>

§ 50. **Can a Majority effect Consolidation upon giving Security to Dissenting Stockholders?** — It was held by the Supreme Court of Pennsylvania in an early case that a consolidation might be effected by the action of a majority of the stockholders of the consolidating corporations, provided dissenting stockholders were secured from loss and their stock

eight weeks delay, placing its decision principally upon the ground that "the injury and disturbance to business affairs is too great and serious as compared to the benefit to be derived therefrom by the complainant to justify that extraordinary remedy."

See also *Tanner v. Lindell R. Co.*, 180 Mo. 1 (1904), (79 S. W. Rep. 155).

It is apparent from the decisions in these recent New Jersey cases that a stockholder who seeks equitable relief in case of an unauthorized consolidation must act with extreme promptitude in that State. The doctrine, however, that great weight should be given to the fact that the unauthorized consolidation has been consummated and business commenced is not without danger. It seems to offer an inducement to hurried action when rights are doubtful.

<sup>1</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453).

<sup>2</sup> *Bell v. Pennsylvania R. Co.* (N. J. 1887), 10 Atl. Rep. 741 (1887). In this case there was five years delay.

When a stockholder fails for two years to bring suit to annul a consolidation and the rights of third persons have intervened a court of equity will not interfere.

*Spencer v. Seaboard Air Line R. Co.*, 137 N. C. 107 (1904), (49 S. E. Rep. 96).

This section is quoted with approval in *Hill v. Atlantic, etc. R. Co.*,

143 N. C. 562 (1906), (55 S. E. Rep. 854).

In *Rabe v. Dunlap*, 51 N. J. Eq. 40 (1893), (25 Atl. Rep. 959), it was held that where a corporation chartered prior to the passage of the consolidation act, consolidated with other corporations for the purpose of carrying on a business essentially different from that for which it was organized, equity might protect the non-assenting stockholders, if application were made promptly; but that equity would not dissolve the consolidated company, and return, free from all liens, the property contributed by the corporation in which complainants were stockholders where for three years they had neglected to ask the aid of equity, and had stood quietly by while the consolidated corporation had incurred liabilities and the rights of third persons had intervened.

In *Douglass v. Concord, etc. R. Co.*, 72 N. H. 26 (1903), (54 Atl. Rep. 883), where the certificate for a non-dividend paying stock had, without the owner's knowledge, remained in the name of her agent for twenty-seven years, when she examined it and then learned for the first time that the corporation had been merged with another nine years before, it was held that as no one had acquired rights or changed his position by reasons of her non-action she had not lost her right to relief by laches.

taken at an appraisal, although no statutory provision sanctioned such course nor removed the necessity for unanimous consent.<sup>1</sup>

While this decision has been referred to apparently with approval in other cases, it is opposed to the weight of authority and contravenes fundamental principles. It is not within the power of courts of law or of equity, in the absence of special statutory authority authorizing the exercise of the power of eminent domain with respect to *quasi*-public corporations, to decree that the stock of dissenting stockholders shall be taken for the purpose of quieting opposition.<sup>2</sup>

The language of Lord Eldon in granting an injunction against an unauthorized extension of the business of a voluntary association at the suit of a dissenting member, although it was

<sup>1</sup> *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42 (1852), (72 Am. Dec. 664). See also *State v. Bailey*, 16 Ind. 46 (1861), (79 Am. Dec. 410).

The decision in the Pennsylvania case seems still to be the law of that State. In *Barnett v. Philadelphia Market Co.*, 218 Pa. 649 (1907), (67 Atl. Rep. 912), the Court said: "The act . . . authorizes consolidation, but does not take away the right of a stockholder to refuse to surrender his stock for that in a new corporation or to take anything less for it than its actual value, if this company is to be practically dissolved. This is all the decree secures to the appellees, and to it they were entitled. *Lauman v. Lebanon Valley R. Co.*, 30 Pa. 42 (1852). A dissatisfied stockholder voting against consolidation 'may' have his damages and the value of his stock ascertained and payment of the same secured in the mode pointed out in that act, but this remedy is not his only one. He may adopt it if he prefers it, but he is not required to do so. The protection given the stockholder in *Lauman v. Lebanon R. Co.* is still to be found in chancery, assuring him actual pay-

ment for his stock, if he is compelled to part with it."

In *McVicker v. Ross*, 55 Barb. (N. Y.) 247 (1869), it was held, in the case of a consolidation of two *joint stock* companies, that although a dissenting shareholder was not obliged to surrender his interests to remaining associates at an estimated valuation, but had the right to have the valuation actually ascertained by a sale, in the ordinary manner of closing up partnerships where there is no express stipulation; yet that where the amount of dissenting stock was inconsiderable in comparison with the stock whose owners had acquiesced in the agreement of consolidation, the court would order the consolidated company to give a bond conditioned that upon final judgment all the property transferred should, if required, be delivered into the custody of the Court for the protection of all the shareholders.

<sup>2</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453); *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 406 (1871); *Mowrey v. Indianapolis, etc. R. Co.*, 4 Biss. (U. S.) 84 (1866).

proposed to indemnify him, is appropriate: "The right of a partner is to hold to the specific purposes his partners while the partnership continues, and not to rest upon indemnities with respect to what he has not proposed to engage in."<sup>1</sup>

§ 51. **The Right to condemn Stock.** — The legislature has power to authorize the consolidation of railroad and other *quasi*-public corporations, without the unanimous consent of their stockholders, when it makes provision for appraising and paying for the stock of dissenting stockholders. This power is entirely unaffected by the constitutional prohibition against impairing the obligations of contracts and is based upon the sovereign power of eminent domain. Corporate shares, as well as all other property, are subject to the paramount necessities of the State for the promotion of public interests.<sup>2</sup> Accordingly, in exceptional instances, statutes have been passed,<sup>3</sup>

<sup>1</sup> *Natusch v. Irving*, 2 Cooper Ch. 358 (1824). See also *Stevens v. Rutland, etc. R. Co.*, 29 Vt. 545 (1851).

<sup>2</sup> In *Spencer v. Seaboard Air Line R. Co.*, 137 N. C. 107 (1904), (49 S. E. Rep. 96), the Court said (p. 121): "The legislature in the exercise of its power confers upon a majority of the stockholders the power to consolidate with the other constituent companies and accept in consideration therefor such number of shares in the new or consolidated corporation as may be agreed upon. This can be done only with the consent of the legislature. The legislature having decided that such consolidation was promotive of the public welfare, recognized that it had no power to compel a dissenting stockholder to accept stock in the new corporation. Therefore, in the exercise of the right of eminent domain it empowers the corporation to condemn the stock of such dissenting stockholder when it cannot otherwise be acquired." (Citing this work.)

(p. 125) "We are of the opinion that the legislature had the power to confer on the corporation the right to condemn the dissenting

stock, and that upon a reasonable interpretation of the statute it has done so. We find no valid objection to the mode prescribed for ascertaining the value of the stock; it is expressly provided that the value so assessed must be paid before the stock is transferred. It would seem that the mode prescribed is exclusive and must be pursued."

In *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 469 (1873), it was held that in the exercise of the right of eminent domain the legislature might authorize shares in corporations and corporate franchise to be taken for public purposes upon just compensation, and that the legislature might, when public necessity required it, grant authority to consolidate or lease, if it provided just compensation for the shares of such stockholders as dissented, and that the act in question did provide compensation for unwilling stockholders, before their property was taken.

See also an article entitled "Corporate Shares and Eminent Domain," by Leonard M. Daggett, published in *Yale Law Journal*, May, 1896.

<sup>3</sup> The statute under consideration



for the promotion of railroad and similar consolidations, providing, under varying conditions, that the stock of dissenting minority stockholders may be appraised and condemned, and such statutes have been held to be constitutional.<sup>1</sup> Statutes of this character are, however, strictly construed, and it has been held that authority to condemn the shares of dissentient stockholders for the purposes of consolidation does not warrant the taking of such shares for the purposes of a lease.<sup>2</sup>

These statutes must be distinguished from the provisions in modern consolidation acts authorizing as a condition of consolidation an appraisal of, and payment for, the stock of objecting stockholders.<sup>3</sup> It is not the purpose of these provisions to authorize the condemnation of stock in order to quiet opposition. Consolidation statutes containing them do not require unanimous stockholders' consent nor can such provisions be made available to obtain the required consent. Their design is to afford the dissenting stockholder an additional remedy, — to give him the privilege of selling out instead of embarking in the new enterprise.

in *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 469 (1873), was the *New Jersey* act of March 17, 1870. See also *Illinois* Stat. 1897, ch. 32, authorizing the exercise of the right of eminent domain in aid of the consolidation of gas companies. Also *Connecticut* Gen. Stat. (1902) §§ 3694, 3695, providing for the condemnation of minority stock interests in railroad and other corporations where the majority of the stock is held by a railroad company, and a court finds that such action will be for the public interest.

<sup>1</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453).

In *Offield v. New York, etc. R. Co.*, 203 U. S. 372 (1906), (27 Sup. Ct. Rep. 72), affirming 78 Conn. 1 (1904), (59 Atl. Rep. 510), the Connecticut statutes referred to in the preceding note were held to be constitutional and valid, — the taking being for a public use.

<sup>2</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453).

<sup>3</sup> See "*Statutory Provisions for Appraisal of Stock*," *post*, § 57.

## CHAPTER V

## METHOD OF CONSOLIDATION

§ 52. Formal Statutory Requisites.

§ 53. When Consolidation is effected.

§ 54. Construction of Statutes prescribing Mode of Consolidation.

§ 55. What Statutory Provisions Conditions Precedent.

§ 56. What Statutory Provisions not Conditions Precedent.

§ 57. Statutory Provisions for Appraisal of Stock.

§ 52. **Formal Statutory Requisites.** — Although, as already noted, it has been held that the consolidation of corporations may be effected by the direct act of the legislature, without any antecedent action on the part of the corporations,<sup>1</sup> such legislative power, if existent, is seldom exercised. Nearly all the States, however, authorize the consolidation of corporations of their own volition and many have enacted general statutes designating the steps necessary to bring about that result.<sup>2</sup> These statutes, while varying in detail, are similar

<sup>1</sup> *Bishop v. Brainerd*, 28 Conn. 289 (1859).

<sup>2</sup> *Alabama*. Code 1896, ch. 28, § 1166 (as amended by acts 1900-1901, p. 237): Directors of railroad companies consolidating enter into an agreement under corporate seal for consolidation, prescribing the terms and conditions thereof, etc. Agreement must be submitted to separate stockholders' meetings and must be sanctioned by a vote of at least *two-thirds* in amount of the stockholders present.

Gen. Laws 1903, No. 117, § 2, prescribe method of consolidating corporations other than railroads.

*Arizona*. R. S. 1901, par. 864: In consolidation of railroad companies agreement "upon such terms as directors of respective companies may agree upon" must be submitted to stockholders of the respective corporations representing *three-fourths* of

the subscribed capital stock and must be ratified and confirmed by such stockholders.

*Arkansas*. Kirby's Digest, 1904, § 6736: To effect consolidation, contract, fixing terms and conditions, must be assented to by *two-thirds* in interest of all the issued capital stock of the companies proposing to consolidate, at a stockholders' meeting regularly called for the purpose.

*California*. Pom. Code 1901, § 473: Method of consolidating railroads same as *Arizona*, *ante*. Code 1886, § 361: Consolidation of mining companies requires consent of holders of *two-thirds* of capital stock.

*Colorado*. Mills Anno. Stat. 1891, § 605, authorizes consolidation of railroad companies under certain conditions by *majority* vote, and § 625 requires a *two-thirds* vote — applicable to consolidation under different statutes.

in their general nature, and the process of consolidation as prescribed in most of them may be outlined as follows:

Consolidation of business corporations requires vote of *three-fourths* of stock, *ib.* § 628.

*Connecticut.* G. S. 1902, §§ 3675, 3676: Directors of railroad companies enter into joint agreement prescribing terms and conditions of consolidation. Agreement must be submitted to stockholders of each company at a special meeting thereof, called separately for the purpose, and if *two-thirds* of all the votes of all the stockholders are for the adoption of the agreement, the companies may consolidate. P. A. 1903, ch. 194, §§ 76, 77, prescribes a similar method for consolidation of business corporations.

*Delaware.* Laws 1899 (Corp. Law), § 54: Directors, or majority of them, enter into an agreement under the corporate seal of respective corporations prescribing terms and conditions. The *written consent* of the owners of at least *two-thirds* of the capital stock of each corporation is necessary to the validity and adoption of the agreement.

Gen. Corp. Law, 1903, § 59: Directors, or majority of them, enter into an agreement under corporate seals of respective corporations. Agreement submitted to stockholders of each corporation at a *meeting* called separately for the purpose, and must be ratified by *two-thirds* in amount of the capital stock.

*Idaho.* Laws 1901, p. 214: Articles stating terms of consolidation must be approved by each corporation by a vote of the stockholders owning a *majority* of the stock (Applies to Laws 1901, "Consolidation").

R. S. 1887, § 2673: No amalgamation or consolidation can take place without the written consent of the holders of *three-fourths* in value of all the stock in each corporation.

*Illinois.* R. S. 1901, § 39, p. 1376: Terms of consolidation must be approved by stockholders owning not less than *two-thirds* in amount of the capital stock of each corporation.

*Indiana.* R. S. 1901 (Burns'), § 5257: Consolidation may be upon such terms as corporations may mutually agree upon in accordance with the laws of the adjoining State with whose road or roads connections are formed.

*Iowa.* Code 1897, § 2036: Consolidation must be made with the consent of *three-fourths* in interest of all the stockholders upon such terms as may be agreed upon.

*Kansas.* G. S. 1905, ch. 84, § 6325: Companies contract, fixing terms, which must be ratified and approved by holders of *two-thirds* of all the stock of each company, either at a meeting of the stockholders called for the purpose or by approval in writing.

*Kentucky.* Stat. 1903, ch. 32, § 555, Art. 1: Directors enter into agreement prescribing terms and conditions, which must be ratified by the owners of at least *two-thirds* of the capital stock of each corporation.

*Louisiana.* R. L. vol. 2, 1904, p. 1485: Terms and conditions are agreed upon in writing by corporations and must be approved by a *majority*, or such a number as may be required by the original charters of consolidating companies.

R. L. vol. 2, 1904, p. 1486: Only formalities required for consolidation are the passage of a resolution to consolidate by the vote of *three-fourths* of all the stockholders, at a special meeting called for the purpose. Louisiana statute relating to consolidation of business corporations (Act of Dec. 12, 1874) requires the assent

(1) The directors of the corporations proposing to consolidate enter into an agreement for the consolidation thereof,

of the owners of *three-fifths* of the stock.

*Maryland.* Pub. Gen. Laws 1904, Art. 23, § 45: Special meeting must be called for the purpose of considering agreement which must be sanctioned by the holders of a *majority* of the stock of the companies.

*Michigan.* Public Acts 1899, p. 450: Directors enter into an agreement under corporate seal prescribing terms and conditions and mode of carrying same into effect. Agreement must be submitted to the stockholders of each corporation separately and sanctioned by votes of *majorities* in interest.

*Minnesota.* Rev. Laws 1905, ch. 58, § 2897: Certificate stating terms of consolidation must be approved by each corporation by vote of stockholders owning a *majority* of the stock or by the written consent of a *majority* of the stockholders attached to the certificate.

*Mississippi.* Code 1906, § 4089: Consolidation is had by the consent of the railroad commission and upon such terms as the companies may agree upon.

*Missouri.* Anno. Stat. 1906, § 1059: Railroad companies enter into agreement which must be ratified and approved by a *majority* in interest of all the stock held in each company, either at stockholders' meetings or by a certificate signed by such *majority* stockholders.

Consolidation of business corporations requires assent of *three-fifths* of stockholders. Anno. Stat. 1906, § 1334.

*Montana.* Civil Code 1895, vol. 2, § 911: Agreement for consolidation of railroad companies, entered into under corporate seals, signed by president and secretaries, containing terms and conditions, must be approved by

stockholders at regular or special meeting by a vote of holders of at least *three-fifths* in amount of capital stock. Consolidation of mining companies requires consent of stockholders holding *three-fifths* of stock. Code, § 527.

*Nebraska.* Comp. Stat. 1905, §§ 2023, 2024: Directors enter into agreement stating terms and conditions which is deemed the agreement of the corporations when it has been submitted to the stockholders of each corporation and sanctioned by vote of at least *two-thirds* in amount of stock represented.

*Nevada.* Cutting's Comp. Stat. (1861-90) § 1011: Manner of consolidation of railroad companies determined by directors. No amalgamation can take place without the written consent of *three-fourths* of stockholders in interest of each company.

*Ib.* § 1075: "All and any corporations" may consolidate upon the written consent or request of the holders of *three-fourths* of the stock upon terms agreed upon by directors or trustees.

*New Jersey.* Gen. Corp. Act 1896, § 105, subdiv. 11: Agreement for consolidation of business corporations must be submitted to stockholders, and vote of *two-thirds* of stock of each company is necessary for its adoption.

*New Mexico.* Comp. Laws 1897, § 3847: Consolidation agreement must be ratified in writing by stockholders of respective corporations representing *three-fourths* of the subscribed capital stock. (Applies to consolidation authorized in that section.)

*Ib.* § 3893: Stockholders agree upon terms and conditions, and submit them to stockholders of each

prescribing the terms and conditions of consolidation, the mode of carrying the same into effect, the name of the new

company at a meeting called separately for that purpose. A vote by ballot taken, and if *two-thirds* of all the votes of all the stockholders shall be for the adoption of the agreement, companies are consolidated. (Applies to *ib.* § 3892.)

*New York.* Birdseye's Rev. Stat. vol. 3, p. 2962 (Railroad Law, § 71): Form of consolidation substantially that stated in text. Approval of stockholders owning *two-thirds* of stock of each corporation is necessary. Business Corp. Law, § 9, contains similar provisions.

*North Dakota.* Rev. Codes 1905, § 4273: Articles stating the terms of consolidation must be approved by each corporation by a vote of the stockholders owning a *majority* of the stock, at a meeting called for the purpose.

*Oklahoma.* Rev. Stat. 1903, vol. 1, p. 360, § 99: Articles stating the terms of consolidation must be approved by a vote of stockholders holding a *majority* of the stock at annual or special meeting, or by consent of such stockholders in writing.

*Ohio.* Bates' Anno. Stat. 1787-1902, § 3381: Directors enter into joint agreement under corporate seal prescribing terms, conditions, etc., which must be submitted to stockholders of each company at meeting called for the purpose; vote by ballot, and if *two-thirds* of all the votes cast at meeting be for adoption, the companies may consolidate.

*Pennsylvania.* Bright, Pur. Dig., 1894, § 108, p. 1801: Directors agree jointly under corporate seal of each corporation, and prescribe terms and conditions. Agreement is submitted to stockholders of each corporation at a meeting called separately; vote by ballot, and if a *majority* of all the

votes cast at each of such meetings shall be in favor of the agreement, companies may consolidate. (Applies to p. 1801, § 107, "Consolidation.")

*Ib.* § 115, p. 1803: Directors agree jointly, prescribe terms, etc. Meeting of each corporation called separately. Agreement submitted to stockholders; vote by ballot. *Two-thirds* of all votes of stockholders required. (Applies to *ib.* § 114, p. 1803).

See also *ib.* § 126, p. 1805; § 182, p. 1814.

*South Carolina.* Code 1902, vol. 1, § 2051: Directors enter into joint agreement prescribing terms, conditions, etc. Agreement is submitted to stockholders of each corporation at a meeting thereof called separately for that purpose. Vote by ballot. *Majority* of votes of all the stockholders is required.

*South Dakota.* Anno. Stat. 1901, § 3906: Terms and conditions agreed upon by directors, but must be ratified and approved by persons holding or representing a *majority* in amount of the capital stock of each of said companies, at annual or special meeting or by approval in writing of *majority* in interest of the stockholders of each company.

*Tennessee.* Code 1896, §§ 1523, 1524: Agreement shall be in writing and set forth the terms and conditions. Must be approved by a *majority* of the stockholders of each of the consolidating companies at a regular meeting. (Applies to § 1522, Code 1896, "Consolidation.")

§ 1533: Agreement must be approved by *majority* of the stockholders of each of the consolidating railroads. (Applies to § 1532, Code 1896, "Consolidation.")

*Utah.* Laws 1901, ch. 26, p. 20,

corporation, the number and names of the directors and other officers, the number and par value of the shares of the capital stock, and the manner of converting the capital stock of the constituent companies into that of the consolidated corporation, with such other details as they may deem necessary to perfect the new organization and the consolidation of the companies.

§ 6: Agreement must specify whether there shall be a merger of one or more companies into another without creation of new company or a consolidation forming a new consolidated corporation. Agreement must be ratified by stockholders of domestic corporation and also by stockholders of any foreign corporation consolidating, in the manner prescribed by the laws of the jurisdiction where such corporation was organized. *Two-thirds* vote required for consolidation of business corporations. R. S. 1898, § 340.

*Virginia.* Code 1904, Tit. 17, ch. 46a, § 1105e (41): Joint agreement of boards of directors of several corporations prescribing the terms and conditions is adopted by a vote of a majority of the stockholders of each merging corporation. The vote and agreement must then be certified to the State Corporation Commission which decides whether certificate of incorporation shall issue.

*Washington.* Ballinger's Anno. Code and Stat. 1897, § 4304: Articles stating terms of consolidation must be approved by each corporation by a vote of the stockholders owning a *majority* of the stock, at annual or special meeting, or by consent in writing of such stockholders annexed to such articles.

*West Virginia.* Code 1906, § 2346: Where two or more railroad corporations incorporated under laws of this State are located or surveyed along the same line, boards of directors may, with the consent of a *majority*

of the stockholders of each corporation, merge or consolidate.

In case of consolidation of foreign and domestic corporation, agreement between the directors of the different companies must be ratified by *two-thirds* of the votes of stockholders of each company.

See also Acts 1901, as amended, p. 236, ch. 108, amending and re-enacting § 53, ch. 54, of Code concerning consolidation of railroads.

Under this statute approval of majority of stockholders of merging corporations is required.

*Wisconsin.* Sanborn's Stat. Supp. (1899-1906) vol. 3, ch. 87, § 1833: Articles stating the terms of consolidation must be approved by each corporation by a vote of the stockholders holding a *majority* of the stock at annual or special meetings or by the consent in writing of such stockholders.

*Wyoming.* R. S. 1899, § 3202: Trustees of corporations enter into agreement under corporate seal of each, prescribing the terms and conditions thereof, etc., and all the stockholders in either of such corporations must ratify. (Applies to (A) in 1899 "Consolidation Act.")

§ 3206: Trustees or directors agree upon terms and conditions which must be ratified and approved by a *majority* in amount of the capital stock of each of companies at annual or special meeting or by approval in writing by a majority in interest of such stockholders. (Applies to (B) in 1899 "Consolidation Act.")

(2) The agreement of the directors is next submitted to the stockholders of each of the companies at a meeting thereof called for the purpose of taking the same into consideration, after due notice to the respective stockholders.

(3) At the stockholders' meeting the agreement is considered and a vote by ballot taken for its adoption or rejection. If the prescribed proportion of the stock of each company is voted for the adoption of the agreement, then that fact is duly certified to, and the agreement, or a certified copy thereof, is filed in the office of the Secretary of State, thus completing the consolidation.

In some of the States, as will be observed, the written consent of a majority or other proportion of the stockholders is required instead of their votes at stockholders' meetings. These statutes treat consolidation as being effected by the act of the *directors*, which the stockholders may approve by their individual assents as well as by their votes.

Where the act authorizing consolidation uses general language and does not clearly designate the means by which the result is to be obtained, the method of consolidation is to be determined by the contracting corporations.<sup>1</sup>

Statutes of some of the States authorizing the consolidation of corporations provide that they "may consolidate their capital stock" and under such a statute it was said, in a New Jersey case, that the *purchase* by one corporation of substantially the entire capital stock of another for the purpose of consolidation, followed by practical consolidation, would be held in equity to be a consolidation in accordance with the statute.<sup>2</sup>

As a general rule, the duration of the consolidated corporation may be fixed in the agreement for consolidation, and the

<sup>1</sup> Dimpfel v. Ohio, etc. R. Co., 9 Biss. (U.S.) 127 (1879), (8 Rep. 641).

<sup>2</sup> Williamson v. New Jersey Southern R. Co., 26 N. J. Eq. 401 (1875): "In fact, the consolidation was actual and complete in all respects. The purchase and sale and delivery of the stock (sixteen-seventeenths of the whole), by virtue of the legislative

authority referred to, for the purpose of consolidation, and the consequent actual, practical and absolute consolidation, completely recognized in all things, will be held in equity to be a consolidation in accordance with the powers of the Acts. If the proceedings are lacking it is not in substance but in form merely; the consolidation has been fully acquiesced in."

period is not restricted by the life of any of the constituent companies.<sup>1</sup>

§ 53. **When Consolidation is effected.** — As the steps pointed out by the consolidation statute must be taken, in addition to the execution of the agreement, to make a consolidation effectual, an agreement to consolidate does not work a consolidation. The *status* of the companies is not affected until the consolidation is completed.<sup>2</sup> The precise time when that result takes place is generally prescribed by the statute, and it is usually provided that the corporations shall be consolidated upon filing the agreement of consolidation in the office of the Secretary of State. Under such a statute it has been held that corporations, parties to an agreement to consolidate, continue in the full enjoyment of their franchises and may accept subscriptions to their capital stock until the agreement is filed.<sup>3</sup>

§ 54. **Construction of Statutes prescribing Mode of Consolidation.** — Under a statute authorizing the consolidation of corporations, upon the written consent of three-fourths in value of the stock of such corporations, the proportion is based upon the number of shares issued and not upon the number authorized;<sup>4</sup> and under the same statute it was held that the fact that trustees consented as the legal owners of stock did not affect the validity of a consolidation.<sup>5</sup>

<sup>1</sup> New York Central etc. R. Co. v. City of Yonkers, 103 N. Y. Supp. 252 (1907). See also Market St. R. Co. v. Hellman, 109 Cal. 571 (1895), (42 Pac. Rep. 225); Rio Grande R. Co. v. Telluride Power, etc. Co., 16 Utah 125 (1897), (51 Pac. Rep. 146). And see *post*, § 60, "*As a General Rule, Effect of Consolidation is Creation of New Corporation and Dissolution of Constituents.*"

<sup>2</sup> Shrewsbury, etc. R. Co. v. Stour Valley R. Co., 21 Eng. L. & Eq. 628 (1853), 2 De Gex, M. & G. 866.

A preliminary plan for consolidation cannot vary the terms of the certificate of consolidation as filed. State v. Consolidated Gas Co., 104 Md. 364 (1906), (65 Atl. Rep. 40).

<sup>3</sup> Mansfield, etc. R. Co. v. Brown, 26 Ohio St. 223 (1875). In McClure v. Peoples Freight R. Co., 90 Pa. St. 269 (1879), where a subscription was made after the agreement for consolidation had been signed, but before it was filed in the office of the secretary of the Commonwealth, it was held that the filing of the agreement in the office of the secretary was not necessary to validate the subscription.

<sup>4</sup> Market St. R. Co. v. Hellman, 109 Cal. 571 (1895), (42 Pac. Rep. 225).

<sup>5</sup> Market St. R. Co. v. Hellman, 109 Cal. 571 (1895), (42 Pac. Rep. 225).

It has also been held in a suit by a stockholder to enjoin an attempted consolidation that the record of stockholders upon the stock book must de-



Railway companies consolidating under the Ohio consolidation act, may agree upon the number and amount of shares of the proposed consolidated company, may classify such stock into "common" and "preferred," and may issue a greater or less number of shares than the aggregate of the constituent companies in order to secure a just and equitable division of property between the shareholders of such corporations.<sup>1</sup>

A statute authorizing the directors, with the assent of three-fifths of the stockholders of the original corporations, to effect a consolidation, does not authorize them to place stock of non-participating stockholders on an inferior footing to their own nor to transfer the rights of such stockholders to a third person without their consent.<sup>2</sup>

A statute<sup>3</sup> providing that any railroad corporation may consolidate its stock with that of a corporation in an adjoining State "upon such terms as may be agreed upon, in accordance with the laws of the adjoining State," does not require that a meeting of the stockholders of a domestic corporation for the purpose of acting upon a proposition to consolidate with a corporation of an adjoining State should be called and conducted in accordance with the laws of such State, but only that the terms of consolidation should not conflict with those laws.<sup>4\*</sup>

termine the persons entitled to vote upon the question of consolidation. *Langan v. Franklyn*, 29 Abb. N. C. 102 (1892), (20 N. Y. Supp. 404).

<sup>1</sup> *Burke v. Cleveland, etc. R. Co.*, 22 Weekly Law Bulletin (Ohio), 11 (1889).

A *Maryland* statute (Code, Art. 81, § 98) provides that each new corporation shall pay a State tax based upon the amount of stock which it is "authorized to have." A consolidation was effected between two corporations, one of which held a controlling interest in the stock of the other. The certificate of consolidation provided for an original issue of stock of a certain amount but stated that when said controlling interest

should be exchanged for the new stock, the latter would be cancelled, thus reducing the amount of the consolidated stock. It was *held* that as the consolidated corporation issued the larger amount of stock it was obliged to pay the tax upon it, although provision was made for the cancellation of part — that it could not be cancelled unless it were issued.

*State v. Consolidated Gas Co.*, 104 Md. 364 (1906), (65 Atl. Rep. 40).

<sup>2</sup> *Fee v. New Orleans Gas Light Co.*, 35 La. Ann. 413 (1883).

<sup>3</sup> *Indiana Rev. Stat.* (1894), § 5257.

<sup>4</sup> *Bradford v. Frankfort, etc. R. Co.*, 142 Ind. 383 (1895), (40 N. E. Rep. 741).

A statute empowering the directors of corporations consolidating to enter into an agreement prescribing the terms and conditions of the consolidation, and the manner of converting the stock of each company into that of the consolidated company, authorizes the insertion in such agreement of a provision that each constituent company shall come into the consolidation free from all indebtedness and the further provision, to accomplish such result, that sufficient of the stock apportioned to each company shall be sold to pay its debts and the remainder only distributed among its stockholders.<sup>1</sup>

§ 55. **What Statutory Provisions Conditions Precedent.** — When corporations undertake to consolidate, the preliminary steps which the statute points out — in so far as they constitute conditions precedent as distinguished from mere directions — must be taken before the consolidation takes effect and the new company comes into existence. Thus, if the statute require the consolidation agreement or a certificate of consolidation to be filed with the Secretary of State, until that is done the new corporation does not exist. “The new corporation, deriving its franchises from the State law, cannot act until the State has the requisite evidence of its claim to corporate existence. The statute is the only source of such existence and its conditions are imperative.”<sup>2</sup> Where it appeared, however, that the certificate was deposited with the Secretary of State, it was held that the law would *presume* that it was recorded, and that the Secretary could be compelled by mandamus to do any necessary ministerial act in the matter.<sup>3</sup> Where the statute provides for the payment of

<sup>1</sup> *Cleveland City R. Co. v. First National Bank*, 68 Ohio St. 582 (1903), (67 N. E. Rep. 1075).

<sup>2</sup> *Peninsular R. Co. v. Tharp*, 28 Mich. 507 (1874). See also *Commonwealth v. Atlantic, etc. R. Co.*, 53 Pa. St. 9 (1866); *Mansfield, etc. R. Co. v. Brown*, 26 Ohio St. 223 (1875); *Mansfield, etc. R. Co. v. Drinker*, 30 Mich. 124 (1874).

<sup>3</sup> In *Commonwealth v. Atlantic, etc. R. Co.*, 53 Pa. St. 9 (1866), it was held that:

(a) Filing in the office of the sec-

retary of the Commonwealth the certificate of consolidation of certain railroad companies constituted the one company thus created a legal corporation in Pennsylvania.

(b) In a *quo warranto* against such company “*nul tiel record*” is well replied to a plea that the defendants became a corporation by contract of consolidation under said act.

(c) It being proved that the certificate was deposited with the secretary of the Commonwealth in his office, the presumption is that he

fees before the consolidation agreement can be filed or recorded the payment of such fees is essential to consolidation.<sup>1</sup> The consolidation agreement must follow the provisions of the statute, and it has been held that a failure to set forth therein the residences of the directors of the consolidated company as required by the statute renders a consolidation invalid when attacked in *quo warranto* proceedings by the State.<sup>2</sup> The election of a new board of directors has also been held, under one statute, to constitute a condition precedent to the acquisition by the consolidated company of the rights and franchises of the constituent companies.<sup>3</sup>

§ 56. **What Statutory Provisions not Conditions Precedent.** — A provision in a consolidation act requiring each of the consolidating corporations to file with the Secretary of State a resolution adopted by the corporation accepting the provisions of the act before they can consolidate, is directory, and a failure to comply therewith does not affect the consolidation, as

filed the same of record and that it remains of record there.

(d) Under a rejoinder that there is such a record with a *prout patet per recordum*, upon inspection of the record and such proof, judgment will be entered for the defendants.

(e) A mandamus will issue, if necessary, to the secretary, to add the date of filing and any other necessary act in the premises.

<sup>1</sup> *State v. Chicago, etc. R. Co.*, 145 Ind. 229 (1896), (43 N. E. Rep. 226). See also *Ashley v. Ryan*, 49 Ohio St. 504 (1892), (31 N. E. Rep. 721), affirmed 153 U. S. 436 (1894), (14 Sup. Ct. Rep. 865).

<sup>2</sup> *State v. Vanderbilt*, 37 Ohio St. 645 (1882): "A fatal defect in the organization of this company is found in the fact that under Rev. Stats, § 3381 (Ohio), the directors of the consolidating companies must set forth in their joint agreement the places of residence of the new directors, as well as their number. This provision of the statute has not been complied with. There is no designation of any

such place of residence. We are not to speculate as to the propriety of this provision nor as to the manner it became incorporated into the statutes in its present form. It is sufficient to say that the provision is in no sense directory and that a compliance with it is indispensable."

<sup>3</sup> *Mansfield, etc. R. Co. v. Drinker*, 30 Mich. 126 (1874): "By that law it will be seen that the corporations were not to become merged until the agreement for consolidation was duly filed in the office of the Secretary of State. This was not done until May 23, 1871. Before that time only an inchoate agreement for consolidation existed and no merger; and it was impossible that any action as a consolidated corporation could take place. The circuit judge held that the election of a board of directors was a condition precedent to its acquiring the rights and franchises of the respective companies, and in that he is supported by the unambiguous provisions of the statute itself."

between stockholders of a constituent corporation and bondholders of the consolidated company.<sup>1</sup> A statute authorizing the consolidation of a domestic corporation with a corporation of an adjoining State "in accordance with the laws of such State" does not require that all the enactments concerning consolidation in such other State should be strictly followed;<sup>4</sup> nor are statutory provisions relating to incorporation applicable to foreign corporations consolidating, under legislative authority, with domestic ones.<sup>3</sup>

The provisions of a general incorporation act requiring directors to be stockholders do not apply to a consolidated corporation formed under a special act containing no such provision.<sup>4</sup> Where the consolidation act did not require notice to be given to the directors of the meeting of the board to act upon an agreement for consolidation, and it was not shown that the articles of association or by-laws of the company required such notice, the unanimous action of a majority of the directors, being a quorum, at a meeting held without notice to all the directors was held valid.<sup>5</sup> The certification upon the agreement of consolidation by the secretaries of the constituent corporations that it has been adopted by their respective companies is not essential.<sup>6</sup> A statutory provision

<sup>1</sup> In *Leavenworth v. Chicago, etc. R. Co.*, 134 U. S. 688 (1890), (10 Sup. Ct. Rep. 708), where a provision for filing with the Secretary of State, by each of the consolidating companies, of a resolution accepting the provisions of the act, passed by a majority of the stockholders, at a meeting called for the purpose, was not observed, it was held that its nonobservance did not render the consolidation void. The Court quoted with approval the following language of the Circuit Court: "It is also a provision which may well be held to be directory, and designed to secure evidence that each of the companies intending to consolidate recognized the statute as the sole authority for such consolidation, and their obligation to be governed by its provisions. If the other essential provisions of the

act were complied with, it does not necessarily follow that the whole proceeding would be void for a failure to comply with this direction of the act."

<sup>2</sup> *Bradford v. Frankfort, etc. R. Co.*, 142 Ind. 383 (1895), (40 N. E. Rep. 741).

<sup>3</sup> *Monroe v. Fort Wayne, etc. R. Co.*, 28 Mich. 271 (1873).

<sup>4</sup> *Camden Safe Deposit, etc. Co. v. Burlington Carpet Co.* (N. J. 1895), 33 Atl. Rep. 479.

<sup>5</sup> *Wells v. Rodgers*, 60 Mich. 527 (1886), (27 N. W. Rep. 671).

<sup>6</sup> *Phinzy v. Augusta, etc. R. Co.*, 62 Fed. 684 (1894).

An agreement for the consolidation of two railroad companies which was duly signed and sealed by the president after the meetings of the directors of both companies had been

requiring notice of consolidation to be published "one month" was held to be complied with by publication in five consecutive issues of a weekly paper and by publication from October 18 to November 17, inclusive, in a daily paper.<sup>1</sup>

§ 57. **Statutory Provisions for Appraisal of Stock.** — While a stockholder in a corporation organized while general consolidation statutes are upon the statute book takes his stock subject to the possibility that the prescribed majority may effect consolidation without his consent, the change is still of a fundamental nature and may materially affect his interests. Recognizing this position of minority stockholders, the policy of several States, as indicated in their consolidation acts, is to provide, as a part of the process of consolidation, for the appraisal of, and payment at the appraisal for, the shares of stockholders who are unwilling to participate in the new enterprise.<sup>2</sup> As said by the Supreme Court of Ohio in *Pittsburg*,

held and the consolidation ordered, was not rendered invalid by the fact that it bore date prior to the meeting of the directors of one company. *Wells v. Rodgers*, 60 Mich. 555 (1886), (27 N. W. Rep. 671).

<sup>1</sup> *Market St. R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225).

<sup>2</sup> The *Delaware* statute (Laws 1903, p. 782, ch. 394, § 61), applicable in the consolidation of business corporations is illustrative of appraisal statutes: "If any stockholder in either corporation consolidating as aforesaid, who objected thereto in writing, shall within twenty days after the agreement of consolidation has been filed and recorded as aforesaid, demand in writing from the consolidated corporation payment of his stock, such corporation shall within three months thereafter pay to him the value of the stock at the date of such consolidation; in case of disagreement as to the value thereof, it shall be ascertained by three disinterested persons, one of whom shall be chosen by the stockholder, one by the directors of the consolidated corporation, and the other by the two

selected as aforesaid; and in case the said award is not paid within sixty days from the making thereof and notice thereof given to said stockholder and consolidated corporation, the amount of the award shall be evidence of the amount due by said corporation and may be collected as other debts are collectible by law; on receiving payment of the award said stockholder shall transfer his stock to the consolidated corporation to be disposed of by the directors thereof or to be retained for the benefit of the remaining stockholders."

See also:

*Alabama*: Acts 1900-1901, p. 237, amending Code 1896, § 1166 (railroads).

*Connecticut*: Pub. Acts 1903, ch. 194, § 79. Almost identical with *Delaware* statute.

*Nebraska*: Comp. Stat. 1907, § 89, p. 535 (railroads).

*New York*: Business Corp. Law as amended to 1907, § 9, is similar to the *Connecticut* and *Delaware* statutes except that it provides for the appointment of appraisers by the courts instead of by the parties, and

*etc. R. Co. v. Garrett.*<sup>1</sup> "From the first statute to the present authorizing the consolidation of railroad companies in this State, it has been the policy of the legislature to require payment to be made to the stockholder of the value of his stock when he refuses to convert it into the stock of the new company."

that both the stockholder and the consolidated company may apply for their appointment.

In *Langan v. Franklyn*, 20 N. Y. Supp. 404 (1892), it was held that this statute did not afford a dissenting stockholder his exclusive remedy but that he might seek relief in equity.

As to whether stockholder is entitled to interest on appraised value of stock, see *Trask v. Peeskill Plow Works*, 6 Hun (N. Y.), 236 (1875).

*New Jersey*: Corp. Act 1896, § 108. This act is similar to that of New York in its form of procedure but applied only to such corporations authorized to consolidate as "shall have the right to exercise any franchise for public use."

Law 1902, ch. 241 applies to corporations "which do not have the right to exercise any franchise for public use," and authorizes appraisal of stock of stockholders not in favor of consolidation.

The directors are bound to propose a consolidation agreement which does not unfairly impair the rights of any class of stockholders and in case an unfair agreement is proposed, a stockholder is not bound to exercise an option between joining in the consolidation and surrendering his stock for appraisal and compensation under the statute just referred to.

*Colgate v. U. S. Leather Co.* (N. J. Ch. 1907), 67 Atl. Rep. 657.

*Ohio*: Anno. Stat. as amended to 1906, § 3388 (railroads). Under this act it is the duty of the railroad company proposing to consolidate to

ascertain who, if any, of its stockholders, refuse to convert their stock into stock of the consolidated corporation and to cause the value of the stock of any who refuse to be ascertained and paid "before the consolidation takes effect"; and it was held that a failure to make demand before the proposed consolidated company acquired the *status* of an incorporated company or a failure to make an attempt to agree with the company as to the value of the stock, did not defeat the right of a stockholder, refusing to convert his stock, to be paid its full value. *Pittsburgh, etc. R. Co. v. Garrett*, 50 Ohio St. 405 (1893), (34 N. E. Rep. 493).

*Pennsylvania*: Laws 1901, p. 349-352, § 5.

It is held that a dissenting stockholder is not bound to pursue his remedy under this statute and have the value of his stock determined, but may bring a bill in equity to enforce payment of its value.

*Barnett v. Philadelphia Market Co.* 218 Pa. 649 (1907), (67 Atl. Rep. 912).

*South Carolina*: Code 1902, § 2057 (railroad companies).

*Wyoming*: Rev. Stat. 1899, § 3022, (railroads).

*England*: Companies' Clauses Consolidated Act (8 & 9 Vict. ch. 16, §§ 128-134), construed in *Re Anglo Italian Bank*, L. R. 2 Q. B. 452 (1867).

<sup>1</sup> *Pittsburgh, etc. R. Co. v. Garrett*, 50 Ohio St. 414 (1893), (34 N. E. Rep. 493).

## CHAPTER VI

EFFECT OF CONSOLIDATION UPON STATUS OF CONSOLIDATING  
CORPORATIONS AND THEIR STOCKHOLDERS

- § 58. Effect of Consolidation may be Fusion, Merger or Continued Existence.
- § 59. Effect of Consolidation depends upon Terms of Consolidation Act.
- § 60. As a General Rule, Effect of Consolidation is Creation of New Corporation and Dissolution of Constituents.
- § 61. Exceptions to the Rule — Merger and Continuance of Corporations.
- § 62. Construction of Particular Consolidation Acts. Cases showing Creation of Distinct Corporation.
- § 63. Construction of Particular Consolidation Acts. Cases of Absorption or Merger.
- § 64. Effect of Valid Consolidation upon Stockholders of Constituent Corporations.

§ 58. **Effect of Consolidation may be Fusion, Merger or Continued Existence.** — As already shown, the term "consolidation" as used in statutes and charters authorizing the union of corporations has acquired no well-defined meaning but is used to describe three forms of corporate conjunction:<sup>1</sup>

(1) The dissolution of all the constituent corporations and the creation, at the same instant, in their stead, of a new and distinct corporation, with franchises, privileges and property derived from those passing out of existence.

(2) The merging of one corporation in another, by which the former only is dissolved and the latter continues its existence, with the franchises, privileges and property of the merging corporation added to its own.

(3) The continuance of all the consolidating corporations, for all purposes, or for formal purposes connected with the winding up of their affairs.

Consolidating corporations often possess valuable privileges and immunities which the consolidated corporation is desirous of succeeding to, but which the courts, as a rule, do not favor,<sup>2</sup> so that the question whether the effect of a particular consoli-

<sup>1</sup> See *ante*, § 8: "*Uses of the Term distinguished.*"

<sup>2</sup> *Yazoo, etc. R. Co. v. Adams*, 180

U. S. 20 (1901), (21 Sup. Ct. Rep. 240); *St. Louis etc. R. Co. v. Berry*, 113 U. S. 465 (1885), (5 Sup. Ct. Rep. 529).

dation is to dissolve the constituent companies is often of much importance.

§ 59. **Effect of Consolidation depends upon Terms of Consolidation Act.** — The word "consolidation" being applied to different processes producing different results, the effect of a consolidation authorized by statute, upon the existence and *status* of the constituent corporations, depends entirely upon the terms and provisions of such statute and the acts and agreements of the consolidating corporations pursuant thereto.<sup>1</sup>

In *People v. New York, etc. R. Co.*<sup>2</sup> the New York Court of Appeals said: "It is perfectly competent for the legislature, in consolidation acts, to declare what shall be the *status* of domestic corporations which shall avail themselves of their provisions, and also of the consolidated company. Whether the consolidation shall create a mere business union between the constituent companies, leaving them in existence as corporations, or whether it shall operate as a surrender of the corporate franchises and the extinguishment of their corporate existences, and a creating a new corporation combining, to the extent permitted by the act, the powers of the corporations out of which it was formed, and vesting in it the property of the constituent companies, depends upon the legislative intention."

The Supreme Court of the United States has said that "if in the statutes there be no words of grant of corporate powers it is difficult to see how a new corporation is created. If it is, it must be by implication, and it is an unbending rule that a grant of corporate existence is never implied."<sup>3</sup> Notwithstanding this *dictum*, as controversies concerning the effect of consolidation nearly always arise in cases turning upon the

<sup>1</sup> *Kéokuk, etc. R. Co. v. Missouri*, 152 U. S. 305 (1894), (14 Sup. Ct. Rep. 592): "In the numerous cases which have arisen in this court as to the effect of a consolidation upon the existence and status of the constituent corporations it has been held that the question of the dissolution of such corporations depended upon the language of the statute under which the consolidation took place."

See also *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 1 (1901), (21 Sup. Ct. Rep. 240); *Railroad Co. v. Georgia*, 98 U. S. 362 (1878).

<sup>2</sup> *People v. New York, etc. R. Co.*, 129 N. Y. 482 (1892), (29 N. E. Rep. 959, 15 L. R. A. 82).

<sup>3</sup> *Central R., etc. Co. v. Georgia*, 92 U. S. 670 (1875).



question whether the consolidated corporation has inherited certain exemptions and immunities from the old companies, not favored by the law, in case the consolidation statute speaks of the consolidated corporation as a "new" corporation, or in any way, even in general terms, indicates an intention to create a new corporation, the courts will not be slow in holding that the effect of the consolidation is to dissolve the old companies and extinguish their special exemptions. "Indeed," says Mr. Justice Brown in a recent case, "it is not too much to say that courts are astute to seize upon evidence tending to show either that such exemptions were not really intended, or that they have become inoperative by changes in the original constitution of the companies."<sup>1</sup>

It is not necessary that the powers of the new corporation should be specially enumerated nor is its *status* affected by reference to the charters of the old companies.<sup>2</sup>

§ 60. As a General Rule, Effect of Consolidation is Creation of New Corporation and Dissolution of Constituents. — One of the earliest decisions upon the subject of the consolidation of corporations was rendered by the Supreme Court of Indiana, which held in *McMahon v. Morrison*<sup>3</sup> that the effect of a consolidation by legislative authority was a dissolution of the original corporations and, at the same instant, the creation of a new corporation with property, liabilities and stockholders derived from those passing out of existence. This decision was approved by the Supreme Court of the United States,<sup>4</sup> and the conclusion there reached has been adopted as appli-

<sup>1</sup> Yazoo, etc. R. Co. v. Adams, 180 U. S. 22 (1901), (21 Sup. Ct. Rep. 240).

<sup>2</sup> Railroad Co. v. Maine, 96 U. S. 510 (1877): "The Maine Central Railroad Company was, upon the consolidation of the original companies, a new corporation, as distinct from them as though it had been created before their existence. The fact that the powers, privileges, and immunities which they had possessed were conferred upon the new company, so far as they could be exercised or enjoyed by it, in no respect affected its character as a

distinct body. A new corporation may be as readily created by the union of two or more corporations as by the union of individuals; and its powers and privileges may as well be designated by reference to the charters of other companies as by special enumeration."

See also *Shields v. Ohio*, 95 U. S. 319 (1877).

<sup>3</sup> *McMahon v. Morrison*, 16 Ind. 172 (1861), (79 Am. Dec. 468).

<sup>4</sup> *Clearwater v. Meredith*, 1 Wall. (U. S.), 40 (1863).

cable to different consolidation statutes in a long line of decisions from many States.<sup>1</sup>

<sup>1</sup> *United States*: *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 1 (1901), (21 Sup. Ct. Rep. 240); *Minneapolis, etc. R. Co. v. Gardner*, 177 U. S. 332 (1900), (20 Sup. Ct. Rep. 656); *Keokuk, etc. R. Co. v. Missouri*, 152 U. S. 301 (1894), (14 Sup. Ct. Rep. 592); *Pullman Palace Car Co. v. Missouri Pac. R. Co.*, 115 U. S. 587 (1885), (6 Sup. Ct. Rep. 194); *Railroad Co. v. Georgia*, 98 U. S. 364 (1878); *Railroad Co. v. Maine*, 96 U. S. 510 (1877); *Shields v. Ohio*, 95 U. S. 320 (1877); *Ridgway Township v. Griswold*, 1 McCrary (U. S.), 151 (1878).

*Georgia*: *Central R., etc. Co. v. State*, 54 Ga. 401 (1875).

*Illinois*: *Ohio, etc. R. Co. v. People*, 123 Ill. 467 (1888), (14 N. E. Rep. 874).

*Indiana*: *Eaton, etc. R. Co. v. Hunt*, 20 Ind. 457 (1863); *State v. Bailey*, 16 Ind. 46 (1861), (79 Am. Dec. 405).

*Iowa*: *Carey v. Cincinnati, etc. R. Co.*, 5 Iowa 357 (1857).

*Louisiana*: *Charity Hospital v. New Orleans Gas Light Co.*, 40 La. Ann. 382 (1888), (4 So. Rep. 433); *Fee v. New Orleans Gas Light Co.*, 35 La. Ann. 413 (1883).

*Maine*: *State v. Maine Central R. Co.*, 66 Me. 488 (1877), affirmed 96 U. S. 510 (1877).

*Missouri*: *State v. Keokuk, etc. R. Co.*, 99 Mo. 30 (1899); (12 S. W. Rep. 290, 6 L. R. A. 222); *Kinion v. Kansas City, etc. R. Co.*, 39 Mo. App. 382 (1889).

*North Carolina*: *Cheraw, etc. R. Co. v. Anson*, 88 N. C. 519 (1883).

*Ohio*: *Shields v. State*, 26 Ohio St. 86 (1875); *State v. Sherman*, 22 Ohio St. 411 (1872).

*Pennsylvania*: *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42 (1858), (72 Am. Dec. 664).

*South Carolina*: *Charlotte, etc. R.*

*Co. v. Gibbes*, 27 S. C. 385 (1887), (4 S. E. Rep. 49).

*Tennessee*: *Miller v. Lancaster*, 5 Cold. 514 (1868).

*Texas*: *Indianola R. Co. v. Fryer*, 56 Tex. 609 (1882).

*Utah*: *Rio Grande R. Co. v. Telluride Power, etc. Co.*, 16 Utah 125 (1897), (51 Pac. Rep. 146).

The rule is clearly stated in a note to *McMahon v. Morrison* in 79 Am. Dec. 424: "The effect of consolidation upon former companies, except so far as the contrary may be provided by the statute authorizing consolidation is, as a general rule, to dissolve all the old corporations and to create a new one, assuming the liabilities, and succeeding to the rights of the old companies."

The reasons for the rule are pointed out by the Supreme Court in *Keokuk, etc. R. Co. v. Missouri*, *supra*: "It is impossible to conceive of a corporation existing without stock, or certificates representing the interests of the corporators in the organization. Now if the act provides that these certificates shall be surrendered and certificates of another company issued in their place, what becomes of the prior companies? Who are their stockholders? Who are their officers? If the stock in the new company is sold, what interest in the prior companies passes by the sale? There can be but one answer to these questions. The property and franchises of the prior companies are gone as much as if they had formally surrendered their charters. The new company may doubtless receive by transmission from its constituent companies their property, rights, privileges and franchises, including any immunity from taxation; but it receives them as one heir receives

As a general rule, therefore, the effect of consolidation is the creation of a new and distinct corporation and the dissolution of the constituent companies. "The general current of authority is to the effect that statutes for the consolidation of domestic corporations are to be treated as acts of incorporation, and that, on consolidation being effected under their provisions, the constituent companies, unless such an intention is excluded by the language of the statute, are deemed to be dissolved, and their powers and faculties to the extent authorized become vested in the consolidated company as a new corporation created by the act of consolidation."<sup>1</sup>

While the "property, liabilities and stockholders" of the new corporation may, in the language of *McMahon v. Morrison*, be "derived from those passing out of existence," the proposition that legislative consent to consolidation has the effect of dissolving the old corporations and creating *eo instanti* a new corporation in their stead, is based upon the theory that the consolidated corporation derives its powers from the act authorizing the consolidation and not from the constituent corporations. As said by Mr. Justice Swayne in *Shields v. Ohio*:<sup>2</sup> "The new organization took the powers and faculties designated in advance in the acts authorizing the consolidation — no more and no less. It did not acquire anything by mere transmission. It took everything by creation and grant."

From the principle that a consolidated corporation takes its rights and powers by creation and grant and not by transmission, it follows that its corporate life is not limited to the

the estate of his ancestor, or as the grantee receives the estate of his grantor, by inheritance, succession or purchase. The result is not a mere union or partnership of two companies, nor a merger of the franchises of one into another, but the extinguishment of one and the creation of another in its place."

As opposed to these authorities the following extract from the opinion in *Phinizz v. Augusta*, etc. R. Co. 62 Fed. 684 (1894), stands alone: "It

must be kept in mind that the consolidation of railroads does not create a new corporation, with powers of its own, distinct from, greater or less than those enjoyed by the consolidating companies separately."

<sup>1</sup> *People v. New York, etc. R. Co.*, 129 N. Y. 482 (1892), (29 N. E. Rep. 959), (*per Andrews, J.*), (15 L. R. A. 82).

<sup>2</sup> *Shields v. Ohio*, 95 U. S. 323 (1877).

unexpired terms of its constituents but extends for the full period fixed in the consolidation agreement under the statutes existing at the time of its execution.<sup>1</sup>

§ 61. **Exceptions to the Rule — Merger and Continuance of Corporations.** — While, as a general rule, the effect of consolidation is the dissolution of the constituent companies, the legislature, by appropriate language, may authorize a consolidation by merger or absorption, in which case the existence of only the merging corporation is terminated.<sup>2</sup> In *Chicago, etc. R. Co. v. Ashling*,<sup>3</sup> the Supreme Court of Illinois said:

<sup>1</sup> In *New Orleans Gas Light Co. v. Louisiana Light, etc. Co.*, 11 Fed. 277 (1882), Judge Pardee considered it a "very serious question . . . whether, if the said two companies could and did unite under the said consolidation act, the life of the amalgamated company could be or was any longer than that of the shorter company so amalgamated. . . . It seems to be undisputed law as derived from the authorities and admitted in argument in this case, that where two companies consolidated under such a law as that of 1874 the old corporations are dissolved, and a new corporation created. What is the life of this new corporation? The law is silent. It seems impossible for either corporation to grant a longer life than it has itself. Whence it ought to follow that the life of the new corporation would only be that of the shorter-lived amalgamating corporation."

The error in this course of reasoning lies in the assumption that the constituent corporations *grant* powers to the new corporation. On the contrary, the latter derives its powers wholly from the consolidation statute, and not at all from them.

The weight of authority supports the text. *New York Central, etc. R. Co. v. City of Yonkers*, 103 N. Y. Supp. 252 (1907); *Market St. R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225); *Rio Grande R.*

*Co. v. Telluride Power, etc. Co.*, 16 Utah 125 (1897), (51 Pac. Rep. 146); *Charity Hospital v. New Orleans Gas Light Co.*, 40 La. Ann. 382 (1888), (4 So. Rep. 433).

<sup>2</sup> In *Central R., etc. Co. v. Georgia*, 92 U. S. 673 (1875), the Supreme Court of the United States said: "If then this construction of the act be correct (and we cannot doubt that it is), that act contemplated no such union and consolidation of the two companies as should work a surrender of their charters by both of them, and the creation of a new company. At most, it intended a merger of the Macon and Western Railroad Company into the other, a mode of transfer of that company's franchise, and property and payment therefor with stock of the Central Company. It is of no importance to the inquiry whether a new corporation was created by the union and consolidation, that the Central acquired under the act new and enlarged powers as well as new stockholders."

See also *Meyer v. Johnston*, 64 Ala. 603 (1879); *New York Central, etc. R. Co. v. Saratoga, etc. R. Co.*, 39 Barb. (N. Y.) 289 (1861); *Eaton v. Hunt*, 20 Ind. 457 (1863). Also *Philadelphia, etc. R. Co. v. Howard*, 13 How. (U. S.) 333 (1851).

<sup>3</sup> *Chicago, etc. R. Co. v. Ashling*, 160 Ill. 382 (1896), (43 N. E. Rep. 373).

“The general rule that the consolidation of two or more corporations into one creates a new company and works a dissolution of the original corporations forming the consolidated company is subject to exceptions and depends upon the statute under which the consolidation is effected. . . . We see no reason why, under the statutes in question, one corporation may not be consolidated with another under the name of such other, which is continued in existence with enlarged powers, franchises and property rights. It is, in substance, so provided, and such consolidations are frequently made.”

Merger, as so authorized, is illustrated by the ordinary case of the absorption by one railroad company, through the interchange of stock, of branches and short connecting roads.

The legislature may also authorize the consolidation of corporations and yet provide for the continued existence of all of them for such formal purposes as may be necessary to wind up their affairs.<sup>1</sup> Indeed, the constituent corporations *may*

<sup>1</sup> The California Civil Code (Sec. 361) authorizing the consolidation of mining companies provides that “no such consolidation shall in any way relieve such companies or the stockholders thereof from any and all just liabilities.” The California Supreme Court held in *Isom v. Rex Crude Oil Co.*, 147 Cal. 663 (1905), (82 Pac. Rep. 319), in view of this provision, that while a consolidated corporation was a distinct entity the consolidation did not dissolve the constituent companies but that they were preserved by law by the purpose of enforcing liabilities against them. The Court said (p. 666): “In the case of a railroad corporation section 473 as amended in 1901 makes provision that a demand against a constituent company may be enforced against the consolidated corporation. No such provision is found in the act relating to mining corporations, and if neither the companies nor their stockholders, by virtue of the consolidation are to be relieved from any just liability, it would seem to require little argu-

ment upon the proposition that their corporate entities are preserved, to the end that they may be served with process and called to defend any action arising either from contract or from tort which may be brought against them.”

In *Edison Electric Light Co. v. New Haven El. Co.*, 35 Fed. 233 (1888), it was held that, by the consolidation of two corporations, the old corporations did not become extinct, so as not to be unable to wind up their business, but that the assignment of the legal title of a patent in writing to the new corporation, by the president and secretary of one of the old corporations, after the consolidation, in pursuance of a vote of its executive committee passed prior thereto, was sufficient to convey such title.

*Bishop v. Brainerd*, 28 Conn. 299 (1859): “No question was there made as to the competency of those legislatures to consolidate these corporations into one, or even to extinguish their original individual existence. In regard to the effect of such

be continued in existence for all purposes; but this form of consolidation as distinguished from a mere alliance, to which the term "consolidation" is inappropriately applied, is confined to the consolidation of corporations of different States.<sup>1</sup>

§ 62. **Construction of Particular Consolidation Acts — Cases showing Creation of Distinct Corporation.** — Where a Louisiana statute authorized the consolidation of two corporations into "one consolidated company holding and enjoying all the rights" belonging to each, it was held that the consolidated corporation was a new corporation, and that the members of the constituent corporations were transmuted into members of the consolidated company.<sup>2</sup>

Under a Maine act, providing that, after filing the consolidation agreement, the corporations making it were "to be consolidated and together to constitute a new corporation," it was held that the consolidated company was a distinct corporation and that the old companies were dissolved.<sup>3</sup>

A consolidation effected under a Mississippi charter providing that "all of the companies so consolidating shall be merged into and *become one company*, and the company so formed shall be deemed and held to be a corporation created by the laws of this State" under which two companies agreed to

a consolidation it does not necessarily follow that it would extinguish, to all intents and purposes, the existence of those corporations. It is possible for them still to subsist for certain purposes notwithstanding they should be thus amalgamated."

See also *Lightner v. Boston, etc. R. Co.*, 1 Lowell (U. S.) 338 (1869); *United States v. Southern Pac. Co.*, 46 Fed. 683 (1891). Compare *Solomonovich v. Denver Cons. Tramway Co.*, 89 Pac. Rep. 60 (Col. 1907).

<sup>1</sup> See *post*, § 102: "Effect of Interstate Consolidation upon Status of Constituent Corporations."

<sup>2</sup> *Fee v. New Orleans Gas Light Co.*, 35 La. Ann. 416 (1883): "The articles of association and the legislative act by authority of which they were executed, evidently present a

case of complete and perfect amalgamation, the effect of which was, under American authorities, to terminate the existence of the original corporations, to create a new corporation, to transmute the members of the former into members of the latter, and to operate a transfer of the property rights and liabilities of each old company to the new one."

See also *New Orleans Gas Light Co. v. Louisiana, etc. Co.*, 11 Fed. 277 (1882), where the same statute was under consideration. Compare, however, *Citizens St. R. Co. v. Memphis*, 53 Fed. 715 (1893).

<sup>3</sup> *State v. Maine Central R. Co.*, 66 Me. 488 (1877), affirmed *sub nom.* *Railroad Co. v. Maine*, 96 U. S. 499 (1877).

consolidate their stock, take a new name, elect a new board of directors, and that the constituent corporations should cease to do business, created a new corporation.<sup>1</sup>

An Ohio statute spoke of the consolidated company as the "new corporation";<sup>2</sup> a Missouri statute spoke of "one company" and provided for the issue of stock in the "new consolidated company";<sup>3</sup> a statute of Arkansas provided that all the property of each company should be taken and deemed to be transferred to the consolidated company "as such new corporation";<sup>4</sup> a Missouri consolidation act spoke of the consolidation as "making one company of the two";<sup>5</sup> a Georgia statute gave the consolidated company the same name as one of the old companies, and conferred upon it full corporate powers.<sup>6</sup> In all these cases the Supreme Court of the United States held that new and distinct corporations were created, and that the constituent companies were dissolved.

A general law of New York authorized any railroad company "organized under the laws of this State . . . to merge and consolidate its capital stock, franchises and property with the capital stock, etc., of any other railroad company, . . ." and provided for the conversion of the stock of the consolidated companies "into that of the new corporation," and it was held that such consolidation created a new and distinct corporation.<sup>7</sup>

Consolidation under the California Civil Code, which provides that the consolidation of corporations may be made "in such manner as may be agreed upon by their respective directors," has been held to make the consolidated corporation "a distinct entity — a new corporation."<sup>8</sup> It would seem,

<sup>1</sup> *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 1 (1901), (21 Sup. Ct. Rep. 240), *affirming* 77 Miss. 194 (1899), (24 So. Rep. 200, 60 L. R. A. 33).

<sup>2</sup> *Shields v. Ohio*, 95 U. S. 319 (1877).

<sup>3</sup> *Pullman Palace Car Co. v. Missouri Pac. R. Co.*, 115 U. S. 587 (1885), (6 Sup. Ct. Rep. 194).

<sup>4</sup> *St. Louis, etc. R. Co. v. Berry*, 113 U. S. 465 (1885), (5 Sup. Ct. Rep. 529).

<sup>5</sup> *Keokuk, etc. R. Co. v. Missouri*, 152 U. S. 301 (1894), (14 Sup. Ct. Rep. 592). See *State v. Keokuk, etc. R. Co.*, 99 Mo. 30 (1889), (12 S. W. Rep. 290).

<sup>6</sup> *Railroad Co. v. Georgia*, 98 U. S. 359 (1878). See *Atlanta, etc. R. Co. v. State*, 63 Ga. 483 (1879).

<sup>7</sup> *People v. New York, etc. R. Co.*, 61 Hun (N. Y.), 66 (1891), (15 N. Y. Supp. 635).

<sup>8</sup> *Market St. R. Co. v. Hellman*, .

however, under such a statute, which involves a legislative delegation of powers, that the effect of a consolidation should depend upon the terms of the agreement actually entered into. A new corporation might or might not be created by such agreement.<sup>1</sup>

A Colorado consolidation statute provides for the transfer of the property of the constituent companies to the consolidated corporation, for the surrender and exchange of stock, and for the assumption of the liabilities of the old companies by the new corporation. It also provides that the stock of the constituent companies, whether exchanged or not, shall represent only an interest in the consolidated corporation. It is held that, upon consolidation, the constituent companies cease to exist, notwithstanding other provisions in the statute that the consolidation shall not affect pending suits or rights of action.<sup>2</sup>

**§ 63. Construction of Particular Consolidation Acts — Cases of Absorption or Merger.** — Where, under a Georgia statute, two railroad companies were authorized "to unite and consolidate" their "stocks" and all their "rights, privileges, immunities, property and franchises," under "the name and charter" of one of the companies through the exchange of shares, it was held by the Supreme Court of the United States

109 Cal. 571 (1895), (42 Pac. Rep. 225). Compare *Isom v. Rex Crude Oil Co.*, 147 Cal. 663 (1905), (82 Pac. Rep. 319).

<sup>1</sup> See *Green County v. Conness*, 109 U. S. 104 (1883), (3 Sup. Ct. Rep. 69).

<sup>2</sup> *Solomonovich v. Denver Cons. Tramway Co.*, 89 Pac. Rep. 57 (Col. 1907). In this case the Court said (p. 60): "The provisions . . . that such consolidation of one corporation with another, or with others, shall not affect suits pending in which such corporations may be parties, nor shall such change affect causes of action nor the rights of parties in any particular, nor shall suits brought against such corporation by its former name be abated, do not, in our opin-

ion, have the effect of keeping alive the corporations formed into a new company by consolidation. . . . The new company, as to pending suits, if it does not want judgment taken, must defend the action or the suit will not abate. As to causes of action upon which suit has not been brought the new company may be made defendant; for if the old company is to be made defendant it is difficult to see how service could be obtained or how provision could be made to depend. There being no stockholders or officers or property or effects, there is no corporation, and the new organization, created by the death of the old companies, is the only organization against which suits can be brought."



that consolidation under this act was not a surrender of the existing charters of the two companies, and did not work the extinction of the absorbing company nor the creation of a new company.<sup>1</sup>

A consolidation of two railroad companies under a Missouri statute giving authority to consolidate "upon such terms as may be deemed just and proper" merges the franchise and privileges of each in the new company, so that they continue to exist with respect to the roads thus consolidated.<sup>2</sup>

Under an Alabama statute, it was held that neither the adoption of a new name, sanctioned by legislative authority, nor the legislative grant of new powers, changed the identity of a corporation nor created a new one, and that, consequently, an act authorizing the consolidation of railroad companies "so as to form one consolidated railway company" under a new name did not create a new corporation.<sup>3</sup> It has also been held that, under an Illinois consolidation act, one corporation may be consolidated with another under the name of the latter, which is continued in existence with enlarged powers, franchises and property rights.<sup>4</sup>

A Virginia corporation having power by its charter to "consolidate with itself" other corporations entered into a consolidation agreement with a corporation chartered in other States and owning connecting lines, whereby all the stock of the latter corporation was cancelled and stock of the former issued in its place. The Virginia company also took over the property of the other corporation and operated its railroad. It was held that the case was one of absorption or merger.<sup>5</sup>

**§ 64. Effect of Valid Consolidation upon Stockholders of Constituent Corporations.** — As elsewhere shown, when a consolidation is invalid for want of the consent of stockholders,

<sup>1</sup> *Central R., etc. Co. v. Georgia*, 92 U. S. 665 (1875).

<sup>2</sup> *Green County v. Conness*, 109 U. S. 104 (1883), (3 Sup. Ct. Rep. 69). Compare *Market St. R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225).

<sup>3</sup> *Meyer v. Johnston*, 64 Ala. 603 (1879). Compare cases cited in note to § 62.

<sup>4</sup> *Chicago, etc. R. Co. v. Ashling*, 160 Ill. 373 (1894), (43 N. E. Rep. 373).

<sup>5</sup> *Lee v. Atlantic Coast Line R. Co.*, 150 Fed. 775 (1906). See also *Vicksburg, etc. Telephone Co. v. Citizens' Telephone Co.*, 79 Miss. 341 (1901), (30 So. Rep. 725, 89 Am. St. Rep. 656).

a dissenting stockholder is released from his subscription;<sup>1</sup> may enjoin the consolidation, and may maintain an equitable action against the consolidated corporation for the wrongful appropriation of his interest in the original corporation.<sup>2</sup>

When, however, the consolidation is valid, either because all the stockholders approve or because the approval of only a part of them is necessary, the rights of stockholders of the consolidating corporations are generally determined by provisions in the consolidation act or agreement. It is usually provided that the consolidated corporation shall issue its shares in exchange for the shares of stockholders of the constituent companies and, as already noticed, objecting stockholders sometimes have the right to take the appraised value of their shares in money instead of the new securities.<sup>3</sup> In the absence of such provisions it is the better view, that, by force of the consolidation proceedings under legislative authority, the stockholders of the constituent corporations are *transmuted* into stockholders of the consolidated companies.<sup>4</sup> The holder of stock in a constituent corporation upon so becoming a stockholder of the consolidated company is entitled to the same proportion of stock in the new company as is secured in the consolidation agreement to his fellow-stockholders and may maintain an action against the new company therefor.<sup>5</sup>

<sup>1</sup> See *ante*, § 47: "*Rights and Remedies of Dissenting Subscribers.*"

<sup>2</sup> See *ante*, § 46: "*Rights and Remedies of Dissenting Stockholders.*"

<sup>3</sup> See *ante*, § 57: "*Statutory Provisions for Appraisal of Stock.*"

<sup>4</sup> See *v. New Orleans Gas Light Co.*, 35 La. Ann. 413 (1883); *Ridgeway Township v. Griswold*, 1 McCrary (U. S.), 151 (1878); *Copland v. Minong Min. Co.*, 33 Mich. 2 (1875). It has been held, however, that a stockholder in a constituent company, not assenting to a consolidation, does not become a member of the consolidated company. *Gardner v. Hamilton Mut. Ins. Co.*, 33 N.Y. 421 (1865). Also *Philadelphia, etc. R. Co. v. Catawissa R. Co.*, 53 Pa. St. 20 (1866).

<sup>5</sup> See *v. New Orleans Gas Light Co.*, 35 La. Ann. 413 (1883).

Where, however, a person had subscribed for stock in a Pennsylvania corporation, paying ten per cent upon his subscription, and thereafter the corporation was consolidated with another company upon an agreement that each stockholder of the former company should be entitled to one share of the consolidated company for two of the old company, and such person then brought an action against the consolidated company to compel the issuance of such new shares to him, it was held that the action should be dismissed; that the plaintiff could not maintain an action against the consolidated company which could not be maintained against

The holder of preferred stock in a constituent corporation has a right of action against the consolidated company, upon a contract of the constituent corporation with its stockholders relating to the payment of dividends upon its preferred stock.<sup>1</sup>

When the effect of consolidation is to create a new corporation, the liability for the corporate debts of stockholders of the consolidating corporations who become stockholders in the consolidated company, is determined by the laws in force at the time of consolidation, and exemptions from liability theretofore attaching to such stockholders are lost.<sup>2</sup>

the old company, and that he was not entitled to a certificate of full paid stock upon which he had paid but ten per cent.

*Babcock v. Schuylkill, etc. R. Co.*, 133 N. Y. 420 (1892), (31 N. E. Rep. 30).

<sup>1</sup> *Boardman v. Lake Shore, etc. R. Co.*, 84 N. Y. 157 (1881). Compare *Prouty v. Lake Shore, etc. R. Co.*, 52 N. Y. 363 (1873).

Where a corporation with preferred stock entered into a consolidation agreement with other corporations wherein it was provided that the consolidated company should assume all the obligations of its constituents, and should deliver to the preferred stockholders bonds maturing at the time of the expiration of their corporation, returning in interest an amount equal to the preferred stock dividends — the security of the bonds being superior to that of the stock — it was held that a preferred stockholder had no ground of complaint, the bonds being the fair equivalent of the stock.

*Beling v. American Tobacco Co.*, 65 Atl. Rep. 725 (N. J. 1907). Compare *Colgate v. U. S. Leather Co.*, 67 Atl. Rep. 657 (N. J. 1907).

Where two railroad companies, in their agreement for consolidation, inserted an article providing for the completion of the route of one of the companies, and the directors of the consolidated company failed to com-

ply with such provisions, it was held that if the duty thus created was owing to all the stockholders, one of the stockholders could not sustain an action against the directors to enforce a compliance therewith; and that if the duty was owing to a class of stockholders having, in respect to the matter, an interest or right distinct from another class, any proceeding to obtain relief for a refusal or neglect on the part of the directors to discharge the duty must bring before the court not only the directors of the company, but the two classes of stockholders.

*Port Clinton R. Co. v. Cleveland, etc. R. Co.*, 13 Ohio St. 545 (1862). See also *Lord v. Copper Mines Co.*, 1 H. & Tw. 85 (1848).

<sup>2</sup> The act of Minnesota of March 2, 1881, ch. 113, authorizing the consolidation of several railroad companies created a new corporation, upon which it conferred the franchises, exemptions and immunities of the constituent companies; but that did not include an exemption of stockholders in the old companies from the payment of corporate debts, or their liability to pay them.

*Minneapolis, etc. R. Co. v. Gardner*, 177 U. S. 332 (1900), (20 Sup. Ct. Rep. 656), affirming *Gardner v. Minneapolis, etc. R. Co.*, 73 Minn. 517 (1898), (76 N. W. Rep. 282).

## CHAPTER VII

## RIGHTS AND POWERS OF CONSOLIDATED CORPORATION

I. *Statutory Transmission of Property, Franchises, and Privileges*

- § 65. General Rule — Legal Presumption.
- § 66. Real Estate and Rights in Streets.
- § 67. Choses in Action.
- § 68. Subscriptions.
- § 69. Enforcement of Subscribers' Obligations — Conditional Subscriptions.
- § 70. Municipal Aid.
- § 71. Constitutional Limitations upon Grants of Privileges and Immunities.
- § 72. Exemptions from Taxation.
- § 73. Special Privileges and Immunities other than Tax Exemptions.

II. *Powers*

- § 74. Powers of Consolidated Corporation — In General.
- § 75. Power to issue Mortgage Bonds.
- § 76. Right of Eminent Domain.
- § 77. Miscellaneous Powers.

I. *Statutory Transmission of Property, Franchises, and Privileges*

§ 65. **General Rule — Legal Presumption.** — When consolidation proceedings are completed the consolidated corporation, according to the usual statutory provision, becomes possessed of all the rights, property, privileges and franchises theretofore vested in its constituent companies.<sup>1</sup> As observed

<sup>1</sup> The provisions of the New York consolidation statute (Birdseye's Rev. Stat. 3d ed. p. 2963, Railroad Law, § 72), are illustrative: "Upon the consummation of said act of consolidation as aforesaid, all and singular the rights, privileges, exemptions and franchises of each of the corporations, parties to the same, and all the property, real, personal and mixed, and all the debts due on whatever account to either of them, as well as all stock and subscriptions and other things in action belonging to either of them, shall be taken and deemed to be transferred to and

vested in such new corporation, without further act or deed; and all claims, demands, property, rights of way and every other interest, shall be as effectually the property of the new corporation as they were of the former corporations, parties to such agreement and act; and the title to all real estate, taken by deed or otherwise, under the laws of this State, vested in either of such corporations, parties to said agreement and act, shall not be deemed to revert or be in any way impaired by reason of this act, or anything done by virtue thereof, but shall be vested

by Judge Holmes, in *John Hancock, etc. Ins. Co. v. Worcester, etc. R. Co.*:<sup>1</sup> "It is usual for consolidating statutes to introduce more or less of the element of succession, or continuity of legal person as to existing rights and duties notwithstanding the fact that in other respects the old and new corporations are not the same. It is for the legislature to say how far the new corporation shall be, as it were, the heir, executor or continuer of the old."

Where, however, the consolidation statute is silent the

in the new corporation by virtue of such act of consolidation."

Other statutory provisions of a similar nature applying to railroads, except where noted, are:

*Alabama*: Code 1896, § 1166 (as amended by Acts of 1900-01, p. 237), § 1168. § 1151 applies to business corporations.

*Arizona*: Rev. Stat. 1901, § 864, par. 3.

*Arkansas*: Kirby's Dig. 1904, § 6735.

*Colorado*: Mills' Anno. Stat. 1891, § 628, p. 688.

*Connecticut*: Gen. Stat. 1902, § 3677; Pub. Acts 1903, p. 173, § 78 (business corporations).

*Delaware*: Laws 1903, § 123, p. 819. Gen. Corp. Law 1899, § 55 applies to business corporations.

*Idaho*: Civ. Code 1901, § 2178.

*Kansas*: Gen. Stat. 1905, § 6325.

*Kentucky*: Stat. 1903, ch. 32, § 556. Stat. 1894, § 556 applies to business corporations.

*Louisiana*: Rev. Laws 1904, pp. 1485, 1486.

*Maryland*: Pub. Gen. Laws 1904, p. 553, § 46.

*Michigan*: Pub. Acts 1899, § 29, p. 451; Comp. Laws 1897, § 30.

*Minnesota*: Rev. Laws 1905, § 2898.

*Missouri*: R. S. 1899, §§ 1059, 1060; Stat. 1889, § 2786 (manfg. companies).

*Montana*: Civ. Code 1895, § 911. § 527 applies to mining companies.

*Nebraska*: Comp. Stat. 1907, § 2023.

*Nevada*: Stat. 1903, p. 139, § 44.

*New Hampshire*: Pub. Stat. & Session Laws 1901, ch. 156, § 22, p. 503.

*New Jersey*: Gen. Corp. Law, 1896, § 106.

*New Mexico*: Comp. Laws 1897, §§ 3847, 3895.

*New York*: Business Corp. Law (amended to 1900), § 10.

*North Dakota*: Rev. Codes 1899, § 2954.

*Ohio*: Bates' Anno. Stat. 1902, §§ 3382, 3384.

*Oklahoma*: Stat. 1893, ch. 17, § 15, par. 1016.

*Pennsylvania*: Bright. Purd. Dig. 1894, p. 1801, §§ 109, 110, 113; p. 1803, § 116; p. 1814, § 182.

*South Carolina*: Code 1902, § 2052.

*South Dakota*: Rev. Code 1903, § 494, p. 649.

*Tennessee*: Code 1896, § 1527.

*Utah*: R. S. 1898, § 341 (business corporations).

*Virginia*: Code 1904, § 1105e (40).

*Washington*: Ballinger's Anno. Code 1897, § 4304.

*Wisconsin*: Stat. & Suppl. 1906, p. 919, § 1833.

*Wyoming*: R. S. 1899, § 3202.

*England*: Railway Clauses Act 1863 (26 and 27 Vict. ch. 92, §§ 38-44).

<sup>1</sup> *John Hancock, etc. Ins. Co. v. Worcester, etc. R. Co.*, 149 Mass. 220 (1889), (21 N. E. Rep. 364).

general rule, based upon the *presumed* intention of the legislature, is the same—that the consolidated corporation succeeds to all the privileges and franchises of each of the constituent corporations with respect to the property acquired from such corporation.<sup>1</sup> “The presumption is, until the contrary appears, that the united or consolidated company has all the powers and privileges, and is subject to all the restrictions and liabilities, of those out of which it was created.”<sup>2</sup>

Generally, the consolidation act confers upon the consolidated corporation all the powers and privileges of its constituents,<sup>3</sup> although it was held under a Maine statute providing

<sup>1</sup> *United States: Keokuk, etc. R. Co. v. Missouri*, 152 U. S. 305 (1894), (14 Sup. Ct. Rep. 592); *Green County v. Conness*, 109 U. S. 104 (1883), (3 Sup. Ct. Rep. 69); *Central R., etc. Co. v. Georgia*, 92 U. S. 665 (1875); *Tomlinson v. Branch*, 15 Wall. 460 (1872); *Lewis v. Clarendon*, 6 Rep. 609 (1878); *Ridgway Township v. Griswold*, 1 McCrary, 151 (1878); *McAlpine v. Union Pac. R. Co.*, 23 Fed. 168 (1885).

*Georgia: Montgomery, etc. R. Co. v. Boring*, 51 Ga. 582 (1874); *Selma, etc. R. Co. v. Harbin*, 40 Ga. 706 (1870).

*Illinois: Chicago, etc. R. Co. v. Moffitt*, 75 Ill. 524 (1874); *Robertson v. Rockford*, 21 Ill. 451 (1859).

*Indiana: Louisville, etc. R. Co. v. Boney*, 117 Ind. 501 (1888), (20 N. E. Rep. 432, 3 L. R. A. 435); *Paine v. Lake Erie, etc. R. Co.*, 31 Ind. 283 (1869).

*Massachusetts: Abbott v. New York, etc., R. Co.*, 145 MASS. 453 (1888), (15 N. E. Rep. 91).

*Mississippi: Louisville, etc. R. Co., v. Blythe*, 69 Miss. 939 (1892), (11 So. Rep. 111, 16 L. R. A. 251, 30 Am. St. Rep. 599).

*Missouri: Thompson v. Abbott*, 61 Mo. 176 (1875).

*Tennessee: Miller v. Lancaster*, 5 Cold. 514 (1868).

<sup>2</sup> *Tennessee v. Whitworth*, 117

U. S. 147 (1886), (6 Sup. Ct. Rep. 649), *per* Waite, C. J.

In *Green County v. Conness*, 109 U. S. 106 (1883), (3 Sup. Ct. Rep. 69), the Supreme Court also said: “When the companies are authorized to consolidate their roads, it is to be presumed that the privileges of each continue to exist in respect to the several roads so consolidated.”

See also *Keokuk, etc. R. Co. v. Missouri*, 152 U. S. 305 (1894), (14 Sup. Ct. Rep. 592).

The consolidation of the property and franchises of different companies by their own act does not enlarge the franchises, powers or privileges of the original companies. The new company takes the rights and privileges it acquired by the consolidation, subject to the original conditions and limitations.

*Consolidated Traction Co. v. Elizabeth*, 58 N. J. L. 619 (1896), (34 Atl. Rep. 146, 32 L. R. A. 170); *Wilbur v. Trenton Pass. R. Co.*, 57 N. J. L. 212 (1894), (31 Atl. Rep. 238).

See also *Tomlinson v. Branch*, 15 Wall. (U. S.) 460 (1872).

<sup>3</sup> *Boston, etc. R. Corp. v. Midland R. Co.*, 1 Gray (MASS.), 359 (1854): “By these proceedings, thus ratified, the consolidated corporation succeeded to and became entitled to exercise all the powers and privileges and subject to the duties and obliga-

that the new corporation should "have the powers, privileges and immunities of each of the corporations," that it acquired the privileges and immunities which *all* the constituent companies had, and did not acquire those special powers, privileges and immunities which some had and which some did not have.<sup>1</sup>

§ 66. **Real Estate and Rights in Streets.** — When consolidation is completed the real estate of the consolidating corporations vests in the consolidated corporation,<sup>2</sup> generally "without any other deed or act of transfer,"<sup>3</sup> and this rule applies in the case of successive consolidations. Thus where land was conveyed in fee simple to a corporation and afterwards that company was consolidated with another and further consolidations took place from time to time, it was held that the new companies formed by the successive consolidations succeeded to the real estate.<sup>4</sup>

Under an act providing that a consolidated street railway company should have all the franchises and be subject to all the duties of its constituents, the right of a constituent corporation to occupy with its tracks the streets of a city passed to the consolidated company.<sup>5</sup> It has also been held that the

tions, of each of the three corporations, as they then stood, and as they were respectively affected by their several acts of incorporation, and by the acts done, the obligations incurred and property held under them."

<sup>1</sup> *State v. Maine Central R. Co.*, 66 Me. 488 (1877) (affirmed *sub nom. Railroad Co. v. Maine*, 96 U. S. 499 (1877)), where it was held: Where a new corporation is formed out of two or more previously existing corporations and by the act creating it is to "have the powers, privileges and immunities possessed by each of the corporations" whose union constitutes such new corporation, the new corporation will have the "privileges, powers and immunities" which they all (*i.e.* every one of them all) had, and it will not have those special powers, privileges and immunities which some had and some did not have.

<sup>2</sup> *Cashman v. Brownlee*, 128 Ind.

266 (1890), (27 N. E. Rep. 560); *Tarpey v. Deseret Salt Co.*, 5 Utah, 494 (1888), (17 Pac. Rep. 631).

<sup>3</sup> A large number of consolidation acts provide that the effects of the consolidating corporations shall vest in the new company by virtue of the consolidation proceedings, "without any other deed or act of transfer."

Where a bank held a contract of guaranty and was absorbed by another bank under a consolidation statute containing a provision similar to that quoted, no assignment was necessary to enable the latter bank to enforce the guaranty.

*Bank of Long Island v. Young*, 101 App. Div. (N. Y.) 88 (1905), (91 N. Y. Supp. 849).

<sup>4</sup> *Cashman v. Brownlee*, 128 Ind. 266 (1890), (27 N. E. Rep. 560).

<sup>5</sup> *Africa v. Knoxville*, 70 Fed. 729 (1895). See also *Pittsburgh, etc. R. Co. v. Reich*, 101 Ill. 157 (1881).

franchises of several street railway companies, contained in their irrevocable charters, to use the streets of a city were not subjected to the liability of legislative repeal by their consolidation, although at the time of consolidation a reserved power to amend or repeal charters was upon the statute book.<sup>1</sup>

A gas company created by the consolidation of several corporations under a statute conferring upon it all their powers,

The charter of a street railway company authorized it to construct and operate a street railway upon certain streets of a city and granted it the privilege of occupying certain other streets at any time within five years. The company built and operated its railroad but did not exercise its option within the prescribed time to lay its tracks in the additional streets. Long afterwards another street railway company obtained the franchise to use one of these additional streets and thereafter the first corporation absorbed it. *Held* that the absorbing company operated the road in the street in question under the franchise acquired by the consolidation and not under the original charter. *Kent v. City of Binghampton*, 81 N. Y. Supp. 198 (1903), 40 Misc. Rep. 1.

Where the original act of incorporation of a railroad company limited the number of tracks upon its railroad to three, and such company consolidated with other companies under a general railroad consolidation statute which contained no limitations upon the powers of corporations organized thereunder with respect to the number of tracks, it was *held* that the consolidated corporation was not restricted by the provision of the original act. "The consolidated corporation possesses all the property and franchises of the constituent corporations and in addition it possesses the general powers of railroad corporations which are not limited to the use of three tracks."

*Colgate v. New York, etc. R. Co.* (N. Y. Sup. Ct. 1906), 100 N. Y. Supp. 650. See also *New York Central, etc. R. Co. v. City of Yonkers* (N. Y. Sup. Ct. 1907), 103 N. Y. Supp. 252.

A street railway company having power to operate in certain streets of a city had a contract with the city by which it was bound to pay a certain proportion of the expense of paving the streets on which it operated, and no more. The contract provided that it should enure "to any company with which it [the street railway company] hereafter becomes merged or consolidated." Subsequently this company consolidated with other corporations and the consolidated company claimed the benefit of the contract with respect to streets not within the territory of the original company — the payment required by the contract being less than that of the general law. It was *held*, however, that the contract only applied to streets in the territory of the corporation which originally had the contract.

*Kent v. City of Binghampton*, 61 App. Div. (N. Y.) 323 (1901), (70 N. Y. Supp. 465).

<sup>1</sup> *Citizens St. R. Co. v. Memphis*, 53 Fed. 715 (1893). Judge Hammond placed his decision in this case upon the ground that the consolidation act did not evidence a legislative intention to create a new and distinct corporation and make the charters subject to repeal. *Compare Railroad Co. v. Georgia*, 98 U. S. 359 (1878).



privileges and immunities has the right, conferred upon such corporations, to lay pipes under streets and highways.<sup>1</sup>

§ 67. **Choses in Action.** — Consolidation statutes generally provide that all *choses in action* of the constituent companies shall, upon consolidation, pass to the consolidated corporation. Without specific designation, they would pass with the other effects of the companies.<sup>2</sup> Thus a consolidated company succeeds to the right to use patents under a license granted to a constituent corporation.<sup>3</sup> An indemnity bond given to a constituent corporation enures to the benefit of the consolidated company and the sureties thereon are liable for breaches taking place both before<sup>4</sup> and after the consolidation.<sup>5</sup> The vesting of *choses in action* of a constituent corporation in the consolidated company by a consolidation act which substitutes it for the original corporation, without prejudice to the other party, passes the right to the new corporation, without express grant, to sue thereon in its own name.<sup>6</sup>

The general rule that *choses in action* of constituent companies enure to the benefit of the consolidated corporation is, however, inapplicable to contracts which from their nature can be carried out by the constituent corporation alone.<sup>7</sup> Thus where a railroad company agreed to give its bonds, in consideration of certain moneys to be paid in instalments, and afterwards by legislative authority becoming consolidated with other companies, bonds of the consolidated company were

<sup>1</sup> Consolidated Gas Co. v. Baltimore County, Commrs. 99 Md. 403 (1904), (57 Atl. Rep. 29).

<sup>2</sup> Under the act of Congress authorizing the consolidation of the Kansas Pacific Railroad with the Union Pacific Railroad it was held that the preëxisting agreements of the former with the government remained unchanged as to compensation for services performed either before or after the consolidation. The Pacific R. R. Cases, 16 Ct. of Claims, 354 (1880).

<sup>3</sup> Lightner v. Boston, etc. R. Co., 1 Lowell (U. S.) 338 (1869).

<sup>4</sup> London, etc. R. Co. v. Goodwin,

6 Eng. Ry. Cas. 177 (1849); 3 Exch. Rep. 320.

<sup>5</sup> Pennsylvania, etc. R. Co. v. Harkins, 149 Pa. St. 121 (1892), (24 Atl. Rep. 175); Eastern Union R. Co. v. Cochrane, 24 Eng. L. & Eg. 495 (1853), 17 Jur. 1103, 23 L. J. Rep. (N. S.) Exch. 61. See also Miller v. Lancaster, 5 Coldw. (Tenn.) 514 (1868).

<sup>6</sup> University of Vermont v. Baxter, 42 Vt. 99 (1869); Miller v. Lancaster, 5 Coldw. (Tenn.) 514 (1868).

<sup>7</sup> New Jersey Midland R. Co. v. Strait, 35 N. J. L. 322 (1872). See also Union Pac. R. Co. v. Gochenour, 56 Kan. 543 (1896), (43 Pac. Rep. 1135).

tendered and suit brought for the money, it was held that such suit would not lie, the consideration offered not being that agreed upon. The Court said: "Neither the court nor the legislature can alter the bargain between these parties. The defendant had the right to stipulate for bonds of a particular company, and it is clear that he cannot be compelled to accept, in lieu of the promised consideration, the obligations of any other company. The consolidated companies, in the nature of things, cannot be the same as one of their constituents. Such a company has larger purposes, wider powers and heavier responsibilities than those inherent in either of its component parts."<sup>1</sup>

§ 68. **Subscriptions.** — Contracts of subscription for stock in a constituent corporation upon which there is an existing liability enure, with other *choses in action*, to the benefit of the consolidated corporation, and it may enforce the obligation of the subscriber, provided the consolidation proceedings are binding upon him.<sup>2</sup>

Where authority to consolidate is contained in the original charters or is authorized by an act in force at the time of the subscription, the provisions of the statutes enter into and form a part of the contract of subscription, and, in case of consolidation, a subscriber is not released from his subscription, and cannot withdraw from the venture.<sup>3</sup> A subscriber is also bound

<sup>1</sup> *New Jersey Midland R. Co. v. Strait*, 35 N. J. L. 322 (1872).

<sup>2</sup> *Wells v. Rodgers*, 60 Mich. 525 (1886), (27 N. W. Rep. 671); *Cooper v. Shropshire Union R., etc. Co.*, 13 Jur. 443 (1849), 6 Eng. Railw. Cas. 136 (1849). See also *Ridgway Township v. Griswold*, 1 McCrary (U. S.), 151 (1878).

<sup>3</sup> In *Nugent v. Supervisors*, 19 Wall. (U. S.) 249 (1873), the Supreme Court of the United States said: "It was therefore, contemplated by the legislature, as it must have been by all the subscribers to the stock of the company, that precisely what has occurred might occur. Subscribers must be presumed to have known the law of the State and to have contracted in

view of it. When the voters of the County of Putnam sanctioned a county subscription by their vote, and when the board of supervisors, in pursuance of that section, resolved to make the subscription, they were informed by the law of the State that a consolidation with another company might be made; that the stock they proposed to subscribe might be converted into stock of the consolidated company, and that the liability they assumed might become owing to that company. With this knowledge and in view of such contingencies they made the contract. The consolidation, therefore, wrought no change in the organization or design of the company to which they sub-

by consolidation proceedings authorized by the legislature in the exercise of its reserved power.<sup>1</sup>

**§ 69. Enforcement of Subscriber's Obligations. Conditional Subscriptions.** — The consolidated corporation may in its own name enforce the liability of subscribers to stock by appropriate actions,<sup>2</sup> but it cannot maintain such actions until all the statutory conditions precedent to consolidation have been complied with and it has acquired a distinct corporate existence.<sup>3</sup> Thus, it has been held under the requirements of different statutes that no such action can be maintained until the consolidated company has elected a new board of directors,<sup>4</sup> or

scribed other than they contemplated at the time as possible and legitimate. It cannot be said that any motive for their subscription has been taken away, or that the consideration for it has failed. Hence the reason of the general rule we have conceded does not exist in this case, and, consequently, the rule is inapplicable. In a multitude of cases decided in England and in this country it has been determined that a subscriber for the stock of a company is not released from his engagement to take it and pay for it by any alteration of the organization or purposes of the company which, at the time the subscription was made, were authorized either by the general law or by special charter, and a clear distinction is recognized between the effect of such alterations and the effect of those made under legislation subsequent to the contract of subscription."

See also:

*Connecticut*: *Bishop v. Brainerd*, 28 Conn. 289 (1859).

*Delaware*: *Delaware R. Co. v. Tharp*, 1 Houst. 149 (1866).

*Illinois*: *Terre Haute, etc. R. Co. v. Earp*, 21 Ill. 291 (1859); *Sprague v. Illinois River R. Co.*, 19 Ill. 174 (1857).

*Indiana*: *Sparrow v. Evansville, etc. R. Co.*, 7 Ind. 369 (1856); *Bish v. Johnson*, 21 Ind. 299 (1863).

*Kentucky*: *Fry v. Lexington, etc. R. Co.*, 2 Metc. 314 (1859).

*Missouri*: *Pacific R. Co. v. Renshaw*, 18 Mo. 210 (1853).

*Ohio*: *Mansfield, etc. R. Co. v. Brown*, 26 Ohio St. 223 (1875).

*Pennsylvania*: *Hamilton v. Clarion, etc. R. Co.*, 144 Pa. St. 34 (1891), (23 Atl. Rep. 53, 13 L. R. A. 779).

*Compare* *Cork, etc. R. Co. v. Patterson*, 18 C. B. 414 (1856), (37 Eng. L. & Eq. 398); *Kenosha, etc. R. Co. v. Marsh*, 17 Wis. 13 (1863).

<sup>1</sup> See cases cited in preceding note. Also *ante*, § 43: "*Requisite Number of Stockholders — (C) Under Enactments in Exercise of Reserved Power.*"

<sup>2</sup> As subscription obligations, with other *choses in action*, pass directly to the consolidated corporation by virtue of the consolidation agreement and proceedings thereunder, an additional formal assignment is unnecessary, but such assignment is sometimes delivered and is convenient, in case of suit, in obviating the necessity for proving the fact of consolidation.

<sup>3</sup> *Midland R. Co. v. Leech*, 3 H. L. Cas. 872 (1852); *Mansfield, etc. R. Co. v. Brown*, 26 Ohio St. 223 (1875); *Rodgers v. Wells*, 44 Mich. 411 (1880), (6 N. W. Rep. 860).

<sup>4</sup> *Peninsular R. Co. v. Tharp*, 28 Mich. 506 (1874).

filed its certificate of consolidation with the Secretary of State.<sup>1</sup> In such an action to enforce an obligation upon a contract made with another corporation, it is necessary for the consolidated corporation to show that it has, and in what manner it has, succeeded to the rights of the original company upon such contract.<sup>2</sup> Proof of the existence of the consolidated company as a corporation *de facto* is not enough. "It may be a corporation *de facto* and entitled, as such, to enforce contracts as against parties who have dealt with it, without at the same time in any manner having succeeded to the rights of the . . . company with which the contract of the defendant was made."<sup>3</sup> Transfer by *assignment* or transfer by *succession* must be shown.<sup>4</sup>

If a subscription to the stock of a constituent corporation is made upon condition, it passes to the consolidated company subject thereto, and that corporation must perform the condition before it can maintain any action upon the subscription. A consolidated corporation may also, by the performance of conditions, accept a continuing conditional offer to subscribe for the stock of one of its constituent companies.<sup>5</sup> Thus, for example, a condition in a subscription to the capital stock of a railroad company that its railroad should pass through a certain place might, upon its consolidation, be complied with by the consolidated company; and the subscription would become absolute on the location of the road through the place named.<sup>6</sup>

<sup>1</sup> Mansfield, etc. R. Co. v. Brown, 26 Ohio St. 223 (1875).

<sup>2</sup> Mansfield, etc. R. Co. v. Drinker, 30 Mich. 124 (1874).

<sup>3</sup> Mansfield, etc. R. Co. v. Drinker, 30 Mich. 124 (1874). See also Tuttle v. Michigan Air Line Co., 35 Mich. 249 (1877); Mansfield, etc. R. Co. v. Brown, 26 Ohio St. 223 (1875); Peninsular R. Co. v. Tharp, 28 Mich. 506 (1874); Brown v. Dibble, 65 Mich. 520 (1887), (32 N. W. Rep. 656).

<sup>4</sup> An assignee of a consolidated corporation of a claim upon a stock subscription of a constituent company must, likewise, fail in his action to collect the same if he does not show

the observance of the statutory conditions to consolidation. Rodgers v. Wells, 44 Mich. 411 (1880), (6 N. W. Rep. 860).

<sup>5</sup> Mansfield, etc. R. Co. v. Pettis, 26 Ohio St. 259 (1875).

<sup>6</sup> Mansfield, etc. R. Co. v. Stout, 26 Ohio St. 241 (1875).

Where a subscription was based on a corporation's locating its road at a certain point, but the road was not built by that company, but by a new company consolidated with one organized on foreclosure of the first company's property and franchise, it was held that the subscription was lacking in consideration, and could not be enforced by the consolidated com-

Calls or requisitions for the payment of subscriptions in instalments, made during the pendency of consolidation proceedings, continue in force after consolidation for the benefit of the consolidated company. Such requisitions apply not only to subscriptions absolute at the date of the call, but to conditional subscriptions as soon as the conditions are performed.<sup>1</sup>

While, generally, consolidation terminates the existence of consolidating corporations so that they cannot thereafter maintain actions,<sup>2</sup> it was held that a constituent corporation might bring an action after consolidation against a subscriber upon his contract of subscription,<sup>3</sup> which could be maintained, unless the fact of consolidation were pleaded in abatement.<sup>4</sup> Upon principle, however, it would seem that the dissolution of the plaintiff corporation might be suggested upon the record at any time.

§ 70. **Municipal Aid.** — Counties and towns through which they ran furnished the principal means by which the early railroads in the Western States were constructed. The policy of rendering such aid was in accordance with the public sentiment of the period.<sup>5</sup> Aid was usually rendered through sub-

pany. *Dix v. Shaver*, 14 Hun (N. Y.), 392 (1878).

<sup>1</sup> *Mansfield, etc. R. Co. v. Stout*, 26 Ohio St. 241 (1875).

<sup>2</sup> *Pennsylvania College Cases*, 13 Wall. (U. S.) 215 (1871): "Neither of the original corporations is competent to sue for any cause of action subsequent in date to their acceptance of the new act of incorporation."

<sup>3</sup> *Hanna v. Cincinnati, etc. R. Co.*, 20 Ind. 30 (1863).

<sup>4</sup> *Swartwout v. Mich. Air Line R. Co.*, 24 Mich. 403 (1872).

<sup>5</sup> In *Scotland County v. Thomas*, 94 U. S. 693 (1876), Mr. Justice Bradley said: "The project of the railroad promised a great public improvement, conducive to the interests of Alexandria and the counties through which it would pass. Its construction, however, would greatly depend upon the local aid and encouragement

it might receive. The interests of its projectors and of the country it was to traverse were regarded as mutual. The power of the adjacent counties and towns to subscribe to its stock, as a means of securing its construction, was desired not only by the company, but by the inhabitants. Whether the policy was a wise one or not is not now the question. It was in accordance with the public sentiment of that period. The power was sought at the hands of the legislature, and was given. It was relied on by those who subscribed their private funds to the enterprise. It was involved in the general scheme as an integral part of it, and as much contributory and necessary to its success as the prospective right to take tolls. Why it should not still attach to this portion of the road, as one of the rights and privileges belonging to it, into

scriptions to stock and payment therefor in municipal bonds, but donations were not uncommon and stand upon the same legal basis as subscriptions.<sup>1</sup>

Upon consolidation the subscription contracts of municipal corporations pass to the consolidated company in the same manner as other subscriptions and it succeeds to their rights to receive municipal aid.<sup>2</sup> The power given by the legislature to a municipal corporation to make a donation in aid of the construction of a railroad is itself a privilege of the railroad corporation, and passes, with other rights and privileges, upon consolidation, to the new company.<sup>3</sup> Where, however, before

whose hands soever it comes, by consolidation or otherwise, it is difficult to see."

<sup>1</sup> *Railroad Co. v. County of Otoe*, 16 Wall. (U. S.) 675 (1872): "It is urged, however, against the validity of the act now under consideration, that it authorized a donation of the county bonds to the railroad company, and it is insisted that if even the legislature could empower the county to subscribe to the stock of such a corporation, it could not constitutionally authorize a donation. Yet there is no solid ground of distinction between a subscription to stock and an appropriation of money or credit. Both are for the purpose of aiding in the construction of the road; both are aimed at the same object, securing a public advantage, obtaining a highway or an avenue to the markets of the country; both may be equally burdensome to the taxpayers of the county. The stock subscribed for may be worthless, and known to be so." See also *New Buffalo v. Iron Co.*, 105 U. S. 73 (1881).

<sup>2</sup> *United States v. Livingston County v. First Nat. Bank*, 128 U. S. 102 (1888), (9 Sup. Ct. Rep. 18); *Bates County v. Winters*, 112 U. S. 325 (1884), (5 Sup. Ct. Rep. 157); *New Buffalo v. Iron Co.*, 105 U. S. 73 (1881); *Harter v. Kernochan*, 103 U. S. 562 (1880); *Menasha v. Hazard*,

102 U. S. 81 (1880); *Empire Township v. Darlington*, 101 U. S. 87 (1879); *Henry County v. Nicolay*, 95 U. S. 619 (1877); *East Lincoln v. Davenport*, 94 U. S. 801 (1876); *Callaway County v. Foster*, 93 U. S. 567 (1876); *Scotland County v. Thomas*, 94 U. S. 682 (1876); *Nugent v. Supervisors*, 19 Wall. (U. S.), 241 (1873); *Washburn v. Cass County*, 3 Dill. (U. S.), 251 (1875); *Lewis v. Clarendon*, 6 Rep. 609 (1878).

*Illinois*: *Edwards v. People*, 88 Ill. 340 (1878); *Robertson v. Rockford*, 21 Ill. 451 (1859); *Niantic Savings Bank v. Douglass*, 5 Ill. App. 579 (1879). *Compare Town of Pana v. Lippincott*, 2 Ill. App. 466 (1877).

*Indiana*: *Scott v. Hanshear*, 94 Ind. 1 (1883).

*Kansas*: *Atchison, etc. R. Co. v. Phillips County*, 25 Kan. 261 (1881); *Chicago, etc. R. Co. v. Stafford County*, 36 Kan. 121 (1887), (12 Pacific Rep. 593). *Compare State v. Nemaha County Commrs.*, 10 Kan. 569 (1873).

*Missouri*: *State v. Greene County*, 54 Mo. 540 (1874); *Smith v. Clark County*, 54 Mo. 58 (1873); *Hannibal, etc. R. Co. v. Marion County*, 36 Mo. 294 (1865).

*Texas*: *Morrell v. Smith County*, 89 Tex. 529 (1896), (36 S. W. Rep. 56).

<sup>3</sup> *Harter v. Kernochan*, 103 U. S. 574 (1880): "The act . . . fully au-

a consolidation was effected, a constitutional provision had been adopted prohibiting county subscriptions without the vote of the people, it was held that the consolidated corporation did not acquire the right of constituent corporations to receive such aid without such vote.<sup>1</sup>

A discussion of the right of consolidated companies to receive municipal aid voted to their constituents is, principally, of historic value. Public sentiment has changed. Public policy as indicated by constitutional and statutory provisions is adverse to municipal aid to railroad companies, and only in exceptional instances is such aid granted at the present time.

§ 71. **Constitutional Limitations upon Grants of Privileges and Immunities.** — Constitutional provisions in many States prohibit the grant of special privileges and immunities.

When consolidation takes the form of merger these provisions are inapplicable, for the privileges and exemptions of the merging companies pass to an *existing* corporation, which takes by transfer and not by grant.<sup>2</sup>

When, however, the effect of consolidation is to dissolve the consolidating companies and to create in their stead a new

thorized the consolidation between those two companies, and upon such consolidation the new company succeeded to all the rights, franchises and powers of the constituent companies. The power in the township to make a donation in aid of the construction of the Illinois South-eastern railway was also a privilege of the latter corporation, and that privilege, upon the consolidation, passed to the new company."

See also *Smith v. Clark County*, 54 Mo. 67 (1873), followed in *Scotland County v. Thomas*, 94 U. S. 682 (1876), and cases cited in preceding note.

<sup>1</sup> *Wagner v. Meety*, 69 Mo. 150 (1878).

In *Harshman v. Bates County*, 92 U. S. 569 (1875), the Supreme Court of the United States held, where authority had been given to a county

court by the electors of a township to subscribe, in its behalf, for stock in a certain railroad company, that, upon principles of the law of attorney and constituent, the consolidation of such company with another revoked the power.

In *Wilson v. Salamanca*, 99 U. S. 499 (1878), however, the Court distinguished the above case from a case where a subscription had been made under similar conditions by a township trustee and clerk, holding that they acted in their official capacity as township authorities and not as mere agents, and that the township was liable.

<sup>2</sup> *Tennessee v. Whitworth*, 117 U. S. 147 (1885), (6 Sup. Ct. Rep. 649); *Central R., etc. Co. v. Georgia*, 92 U. S. 665 (1875); *Southwestern R., etc. Co. v. Georgia*, 92 U. S. 676, note (1875).

and distinct corporation this new corporation takes everything by grant — express or by reference — and the legislature is controlled by existing constitutional limitations in granting it privileges.<sup>1</sup> The new consolidated corporation is subject to all constitutional provisions in force at the time of its creation in precisely the same manner as other new corporations. Where corporations enjoying irrevocable privileges and exemptions consolidate and a new corporation is created it takes such privileges subject to constitutional or statutory provisions reserving to the legislature power to repeal the charter provisions granting them.<sup>2</sup>

Questions as to the effect of constitutional provisions upon the special immunities of consolidating corporations generally arise in connection with exemptions from taxation and are further considered in the next section.

§ 72. **Exemptions from Taxation.** — As already indicated, the purpose of acts permitting the merger of corporations is, generally, to vest in the absorbing company the privileges and immunities, including exemptions from taxation, of the companies absorbed, and such is the legal presumption.<sup>3</sup> The merger does not, however, enlarge the rights acquired nor bestow new immunities.<sup>4</sup> Thus, where one railroad corpora-

<sup>1</sup> *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 1 (1901), (21 Sup. Ct. Rep. 240); *Minneapolis, etc. R. Co. v. Gardner*, 177 U. S. 332 (1900), (20 Sup. Ct. Rep. 656); *Norfolk, etc. R. Co. v. Pendleton*, 156 U. S. 673 (1895), (15 Sup. Ct. Rep. 413); *St. Louis, etc. R. Co. v. Berry*, 113 U. S. 465 (1885), (5 Sup. Ct. Rep. 529); *Railroad Co. v. Georgia*, 98 U. S. 359 (1878); *Railroad Co. v. Maine*, 96 U. S. 499 (1877); *Shields v. Ohio*, 95 U. S. 319 (1877); *Keokuk, etc. R. Co. v. Scotland County*, 41 Fed. 305 (1890). See also *State v. Northern Central R. Co.* 44 Md. 131 (1875).

After the adoption of a new constitution a railroad company chartered prior thereto which consolidates with other corporations takes all privileges and franchises subject to its provisions.

*San Antonio Traction Co. v. Altgelt*, 200 U. S. 304 (1906) (26 Sup. Ct. Rep. 261).

<sup>2</sup> *Railroad Co. v. Georgia*, 98 U. S. 359 (1878). See also cases cited in note 1. *Compare Citizens' Street R. Co. v. Memphis*, 53 Fed. 715 (1893). See *ante*, § 66: "*Real Estate and Rights in Streets*."

<sup>3</sup> *Tennessee v. Whitworth*, 117 U. S. 147 (1885), (6 Sup. Ct. Rep. 649).

<sup>4</sup> *Central R., etc. Co. v. Georgia*, 92 U. S. 675 (1875). "The obvious purpose of the act was to vest in the Central Company the rights, privileges, immunities, property, and franchises which had belonged to the Macon and Western Company; not to enlarge those rights, or to bestow new immunities. If, therefore, the Macon and Western held its fran-



tion which enjoyed an exemption from taxation for a limited period was merged in another company having a perpetual exemption, it was held that such perpetual exemption did not apply to the railroad of the absorbed company, and that it became subject to taxation upon the expiration of the period limited.<sup>1</sup>

Where a new corporation is created as the result of consolidation the question whether it acquires the exemptions from taxation enjoyed by its constituent companies depends upon the constitution of the State and the terms of the consolidation act. If the constitution prohibits the grant of such exemptions they cannot, as shown in the last section, be bestowed on the consolidated company.<sup>2</sup>

Where the constitution contains no prohibition of such exemptions, their existence depends entirely upon the provisions of the consolidation act. The courts view such exemptions with disfavor and in construing consolidation statutes hold that, in the absence of an express statutory direction or of an equivalent implication by necessary construction,

chises and property subject to taxation, the Central, succeeding to the franchises and property, holds them alike subject. It took them just as they were, acquiring no additional or enlarged rights as against the State."

See also *Southwestern R., etc. Co. v. Georgia*, 92 U. S. 676 (1875), in note to above case. Also *Keokuk, etc. R. Co. v. Missouri*, 152 U. S. 301 (1894), (14 Sup. Ct. Rep. 592); *State v. Philadelphia, etc. R. Co.*, 45 Md. 361 (1876), (24 Am. Rep. 511).

<sup>1</sup> *Tomlinson v. Branch*, 15 Wall. (U. S.) 460 (1872).

<sup>2</sup> In *St. Louis, etc. R. Co. v. Berry*, 113 U. S. 465 (1885), (5 Sup. Ct. Rep. 529), it was held: A consolidation of two railway companies by an agreement which provided that all the property of each company should be taken and deemed to be transferred to the consolidated company "as such new corporation without further act or deed," created a new corpora-

tion, with an existence dating from the time when the consolidation took effect, and subject to constitutional provisions respecting taxation in force in the State at that time.

In *Keokuk, etc. R. Co. v. Scotland County*, 41 Fed. 305 (1890), the Court said that a consolidation of two railroad companies under the Missouri consolidation act operated as the creation of a new corporation, wholly distinct from the constituent corporations out of which it was formed, which new corporation derived its powers and franchises from the consolidation act; and since Const. Mo. 1865, Art. 11, par. 16, prohibiting legislative exemption from taxation, was adopted before the passage of the act, the consolidated corporation did not acquire the immunity from taxation granted in 1857 to one of its constituent corporations.

See also cases cited in notes to preceding section.

exemptions from taxation in the charters of consolidating corporations do not pass to the new corporation succeeding by consolidation to their property and ordinary franchises.<sup>1</sup>

In the case of *Yazoo, etc. R. Co. v. Adams*<sup>2</sup> Mr. Justice Brown said: "Exemptions from taxation are not favored by law, and will not be sustained unless such clearly appears to have been the intent of the legislature. Public policy in the United States has almost necessarily exempted from the scope of the taxing powers large amounts of property used for religious, educational and municipal purposes; but this list ought not to be extended except for very substantial reasons; and while, as we have held in many cases, legislatures may in the interest of the public, contract for the exemption of other property, such contracts should receive a strict interpretation, and every reasonable doubt be resolved in favor of the taxing power. Indeed, it is not too much to say that courts are astute to seize upon evidence tending to show either that such exemptions were not originally intended, or that they have become inoperative by changes in the original constitution of the companies."

Where, however, the consolidation act provides that the consolidated corporation shall be "vested with all the immunities" of the old companies, or uses other language clearly evidencing a legislative intent to bestow such special privileges upon the consolidated corporation, it thereby succeeds to an exemption from taxation contained in the charter of a constituent corporation.<sup>3</sup> Such an exemption, however, applies

<sup>1</sup> *Norfolk, etc. R. Co. v. Pendleton*, 156 U. S. 673 (1895), (15 Sup. Ct. Rep. 413): "We have frequently held that, in the absence of express statutory direction, or of an equivalent implication by necessary construction, provisions, in restriction of the right of the State to tax the property or to regulate the affairs of its corporations, do not pass to new corporations succeeding, by consolidation or by purchase under foreclosure, to the property and ordinary franchises of the first grantee."

See also *Petersburgh v. Peters-*

*burgh R. Co.*, 29 Gratt. (Va.) 773 (1878).

For consideration of the question of irrepealable contracts with the State on the subject of taxation passing to consolidated corporation see *State v. Commr. of Railroad Taxation*, 37 N. J. L. 240 (1874).

<sup>2</sup> *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 22 (1901), (21 Sup. Ct. Rep. 240). See also *Railroad Co. v. Georgia*, 98 U. S. 363 (1878); *Railroad Co. v. Maine*, 96 U. S. 308 (1877).

<sup>3</sup> *Atlantic, etc. R. Co. v. Allen*, 15 Fl. 637 (1876). In this case the act

only to the property to which it adhered when enjoyed by the original company. "Whatever property was subject to taxation would, after the consolidation, remain so."<sup>1</sup>

Improvements, betterments and repairs made upon the properties by the consolidated company are subject to taxation or exemption according to the rule applied to the respective properties upon which they were made.<sup>2</sup>

provided that "all the rights, franchises and privileges" should pass, and the Court said: "A right of exemption from taxation can be passed under the general language 'all the rights' the same as any other right. We can see no difference. . . . The term 'all rights' embraces each right."

See, however, *post*, § 160: "*Exemptions from Taxation.*"

In *Natchez, etc. R. Co. v. Lambert*, 70 Miss. 779 (1893) the Court said: "If the words 'rights, privileges, and immunities' do not include its immunity from taxation it would be difficult to pass it except by an express declaration that exemption from taxation should be among the rights, privileges and immunities to be transferred."

<sup>1</sup> A railroad corporation, formed under an act of the legislature by the consolidation of existing companies and "vested with all the rights, privileges, franchises, and property which may have been vested in either company prior to the act of consolidation," acquires no greater immunity from taxation than they severally enjoyed as to the portions of the road which belonged to them under their respective charters. Whatever property was subject to taxation would, after the consolidation, remain so. *Chesapeake, etc. R. Co. v. Virginia*, 94 U. S. 718 (1876).

See also *Central, etc. R. Co. v. Georgia*, 92 U. S. 665 (1875); *Branch v. Charleston*, 92 U. S. 677 (1875); *Tomlinson v. Branch*, 15 Wall. 460 (1872); *Charleston v. Branch*, 15

Wall. (U. S.) 470 (1872), *note*; *Dela-ware R. R. Tax.*, 18 Wall. 206 (1873); *Philadelphia, etc. R. Co. v. Maryland*, 10 How. 377 (1850); *State v. Woodruff*, 36 N. J. L. 94 (1872); *State v. Philadelphia, etc. R. Co.*, 45 Md. 361 (1876), (24 Am. Rep. 511).

<sup>2</sup> *Branch v. Charleston*, 92 U. S. 682 (1875): "It does not follow, therefore, that this part of the road, though used for the accommodation of both branches, should be regarded as divisible into proportional parts, one subject to taxation and the other not. It is to be regarded as simply the road and property of the old company; in the hands of the new company it is true, but subject to all the liabilities of its original charter. Hence we held that the entire line of road between Branchville and Charleston is subject to taxation; and that *prima facie* the railroad terminus and depot in Charleston and the property accessory thereto belong to the older portion of the joint property. But inasmuch as the charter right of the present company extended to Charleston, we further held, that if it could be fairly shown that any of the company's property there was acquired by the present company for the accommodation of the business belonging to its original roads, or for the joint accommodation of the entire system of roads under its control, such property would, *pro tanto* and in fair proportion, be exempt from taxation. This was intended to meet the case of such property as the present company might have acquired in

A conditional exemption from taxation dependent upon certain returns being made and certain acts performed, which the consolidated corporation is neither required nor able to make or perform, does not enure to its benefit.<sup>1</sup>

§ 73. **Special Privileges and Immunities other than Tax Exemptions.** — Where a corporation having the exclusive franchise to furnish water to a city is consolidated with another corporation under a statute providing that upon consolidation, the separate existence of the constituent corporations shall cease, and that the consolidated corporation shall be subject to existing laws, the exclusive franchise does not pass to the new company if the statutes at the time of the consolidation are opposed to such exclusive privileges.<sup>2</sup> The provisions of the consolidation acts may be such, however, that an exclusive privilege of this character will pass to the consolidated corporation.<sup>3</sup>

A consolidated railroad corporation may acquire the limited liability of one of its constituents for damages for killing live stock.<sup>4</sup> A provision in the charter of a constituent corporation exempting its officers, agents and servants from military and road duty and from serving on juries, has been held not to be a mere personal privilege conferred upon the classes of persons

Charleston, either separately or in conjunction with the old company, had no consolidation taken place, and had the line between Branchville and Charleston, used by both, remained the property of the old company. Of course, in carrying out this principle, any repairs or improvements made on the old line or the property of the old company would become a part thereof, and be subject to taxation."

<sup>1</sup> *State v. Maine Central R. Co.* 66, Me. 499 (1877): "The defendant's claim to immunity from taxation or for a limited and conditional taxation rests only on the word 'immunities' in section 4. But to entitle them to immunity they must first of all be enabled or required to make the several returns, and do and perform the several acts upon which such

limited taxation is to be based. But that they are not so enabled or required, will be fully seen. Nor is it pretended or alleged that such acts have been done." *Affirmed sub nom. Railroad Co. v. Maine*, 96 U. S. 508 (1877).

<sup>2</sup> *Shaw v. City of Covington*, 194 U. S. 593 (1904), (24 Sup. Ct. Rep. 754).

<sup>3</sup> *New Orleans Gas Co. v. Louisiana Light, etc. Co.*, 115 U. S. 650 (1885), (26 Sup. Ct. Rep. 52). In this case it was held that upon a consolidation of gas light companies the consolidated corporation obtained the exclusive privilege of a constituent company to supply a city with gas.

<sup>4</sup> *Daniels v. St. Louis, etc. R. Co.*, 62 Mo. 43 (1876) (sale).

described, but a valuable right in the company which passes upon consolidation to the consolidated company.<sup>1</sup>

## II. Powers

§ 74. **Powers of Consolidated Corporation. In General.** — When consolidation is effected through a process of merger the absorbing corporation continues in existence with its original powers and with such additional powers, derived from the corporations absorbed, as the consolidation statute may confer.

When, however, the original corporations are dissolved and a new and distinct corporation is created, the consolidation act is treated as a grant of a new charter to the consolidated corporation<sup>2</sup> which acquires and can exercise no powers not granted expressly or by necessary implication therein.<sup>3</sup> It will be implied that the consolidated company takes and may exercise the powers necessary for the use of the property and franchises, and for the transaction of the business acquired.

The consolidation statute need not specifically enumerate the corporate powers conferred, but may, and usually does, designate the powers and privileges granted by reference to the powers of the constituent companies. "Powers and privileges may as well be designated by reference to the charters of other companies as by special enumeration."<sup>4</sup> The

<sup>1</sup> *Zimmer v. State*, 30 Ark. 677 (1875). Compare, however, *St. Louis, etc. R. Co. v. Berry*, 41 Ark. 509 (1883). See also *Hawkins v. Small*, 7 Baxt. (Tenn.) 193 (1874).

Where the employees of a Tennessee corporation were exempt from road work and the corporation was incorporated in Alabama with the same privileges it was held that the employees were likewise exempt from such duty in Alabama. *Johnson v. State*, 88 Ala. 176 (1889), (7 So. Rep. 253).

<sup>2</sup> In *Shields v. Ohio*, 95 U. S. 323 (1877), Mr. Justice Swayne said: "When the consolidation was completed, the old corporations were de-

stroyed, a new one was created, and its powers were 'granted' to it, in all respects, in view of the law, as if the old companies had never existed, and neither of them had ever enjoyed the franchises so conferred."

See also *Charlotte, etc. R. Co. v. Gibbs*, 27 S. C. 385 (1887), (4 S. E. Rep. 49).

<sup>3</sup> *Shields v. Ohio*, 95 U. S. 323 (1877); *Mead v. New York, etc. R. Co.*, 45 Conn. 199 (1877).

<sup>4</sup> *State v. Keokuk, etc. R. Co.*, 99 Mo. 41 (1889), (12 S.W. Rep. 290, 6 L. R. A. 222).

Also *Shields v. Ohio*, 95 U. S. 323 (1877): "The language was brief and was made operative by reference.

privileges so granted by reference, however, while similar to those of the former companies, are not the same. They are, essentially, privileges of the new corporation, to be exercised according to its constitution and for the purposes of its creation.<sup>1</sup>

The amount of capital stock which the consolidated corporation is authorized to issue is generally fixed by the consolidation act with reference to the amounts issued by the companies consolidating; and, in some States, it is provided that the capital stock of the consolidated corporation shall not exceed the total amount of the capital of its constituents.<sup>2</sup>

§ 75. **Power to issue Mortgage Bonds.** — General consolidation statutes often provide that the consolidated company

But this did not affect the legal result. A deed *inter partes* may be made as effectual by referring to a description elsewhere as by reciting it in full in the present instrument."

<sup>1</sup> Where a new corporation is formed out of two existing corporations, which, under the terms of the consolidation, cease to exist, the law creating the new corporation controls in determining what are its corporate powers and franchises. *Crawfordsville, etc. Turnpike Co. v. Fletcher*, 104 Ind. 97 (1883), (2 N. E. Rep. 243). For references to consolidation statutes providing generally that the consolidated company shall possess all the powers, rights, franchises, etc. of the consolidating corporations, see note to § 65, *ante*.

Where a railway company and a dock company amalgamated under an English statute providing that the two undertakings should form one and be the undertaking of the railway company, but that no provision of the statutes which related exclusively to one of the undertakings should apply to the other, and the railway company supplied their dock undertaking with water derived from land acquired for its railway, it was held that the railway company was not carrying on the business of a

water company, and that, there being no statutory prohibition, it was not acting *ultra vires*. *Atty. Gen. v. North-Eastern Ry.* 2 Ch. 675 (1906), (95 L. T. 512, 76 L. J. Ch. 5, 70 J. P. 473, 22 T. L. R. 695).

<sup>2</sup> *Connecticut*: Gen'l Stat. 1902, § 3807.

*Idaho*: Session Laws 1901, p. 214, § 2.

*New York*: Railroad Law, § 71, Birdseye's R. S. Sup. Vol. 4, 1905.

*North Dakota*: Rev. Code, 1905, § 4273.

*Oklahoma*: Rev. Stat. 1903, p. 360, § 1082.

*Washington*: Ballinger's Anno. Stat. 1897, § 4304.

In *New Hampshire* the capital stock of the consolidated company may not exceed the shares of the constituent corporations "actually issued and paid for at par." (Pub. Stat. 1901, ch. 156, § 26, p. 504.)

In *Pennsylvania* the amount of the capital stock is not limited to the amount of the issues of the consolidating companies and is fixed in the consolidation agreement. (Bright, *Purd. Dig.* 1903, vol. 1, ch. XI, p. 785.) See also as to power to increase stock, *Alabama Code*, § 1150. *New Jersey Railroad Law*, par. 252-3 (G. S. 1895, p. 2698).

may, under prescribed conditions, issue bonds and secure them by mortgage of its property and franchises,<sup>1</sup> and may exchange the bonds so issued for the bonds of its constituent companies.<sup>2</sup>

Under authority to issue mortgage bonds, it has been held that a consolidated corporation may do so for the purpose of taking up bonds previously issued by a constituent corporation.<sup>3</sup> A consolidated company may also purchase and retire the bonds of its constituents.<sup>4</sup>

Consolidation acts sometimes stipulate that no bonds or other evidences of indebtedness shall be issued as a consideration for or in connection with a consolidation.<sup>5</sup>

**§ 76. Right of Eminent Domain.** — A consolidated corporation acquires, among its powers and privileges, the right to condemn property under the power of eminent domain granted to a constituent corporation.<sup>6</sup>

<sup>1</sup> *Colorado*: Mills' Anno. Stat. 1891, ch. 30, § 607.

*Connecticut*: Gen. Stat. 1902, § 3807.

*Georgia*: Code 1895, § 2179.

*New Jersey*: Laws 1903, p. 680, § 70.

*New York*: Railroad Law, § 72, Birdseye's R. S. 1905.

*Ohio*: Bates' Anno. Stat. 1906, § 3399 A.

*Pennsylvania*: Bright. Purd. Dig. 1894, §§ 110, 111, p. 1802.

*Tennessee*: Code 1896, § 1528, par. 5; Code 1884, § 1269.

<sup>2</sup> *New Jersey*: Laws 1903, p. 680, § 70.

*New York*: Railroad Law, § 72, Birdseye's R. S. 1905.

*Pennsylvania*: Bright. Purd. Dig. 1894, §§ 110, 111, p. 1802.

Consolidation statutes also sometimes limit the amount of bonds and their rate of interest and prescribe the method to be followed in issuing them.

<sup>3</sup> *Camden Safe Deposit, etc. Co. v. Burlington Carpet Co.* (N. J. 1895), 33 Atl. Rep. 479.

<sup>4</sup> *Shaw v. Norfolk County R. Co.*,

16 Gray (Mass.), 411 (1860): "Then [upon consolidation] the Boston and New York Railroad Company, having become the owners of the franchises and property of the Norfolk County Railroad Company, subject to the rights of their creditors, could either become purchasers of the outstanding bonds, and hold them like other creditors, or could pay and extinguish them for the relief and discharge of their own property, as they should deem it best for their interest and advantage to do."

<sup>5</sup> *Connecticut*: Gen'l Stat. 1902, § 3675.

*Idaho*: Session Laws 1901, p. 214, § 2.

*New York*: R. R. Law, § 71, Birdseye's R. S. Sup. vol. 4, 1905.

*North Dakota*: Revised Codes 1899, § 2954.

*Oklahoma*: Stat. 1903, p. 360, § 99.

*Washington*: Ballinger's Anno. Stat. 1897, § 4304.

<sup>6</sup> *Abbott v. New York, etc. R. Co.*, 145 Mass. 450 (1888), (15 N. E. Rep. 91). See also *South Carolina R. Co. v. Blaké*, 9 Rich. (S. C.) 228 (1856);

It has been questioned whether it takes this power as a *quasi*-successor of the constituent corporation to which it was originally granted or whether the transfer operates as a new grant of the power, upon the same terms, to the consolidated company. In *Abbott v. New York, etc. R. Co.*<sup>1</sup> the Supreme Judicial Court of Massachusetts said: "It seems to us equally clear that a corporation, by consent of the legislature, may take this power as *quasi*-successor of another corporation to which it was originally granted, and it is not very material whether the legislature be regarded as authorizing a transfer of the old power, or, more strictly, as delegating a new power in the same terms as the old. The substance of the transaction is seen in cases of consolidation." Upon the principle, however, that a consolidated corporation takes everything by creation and grant it seems the better view that the consolidation statute operates as a new grant of this and other powers.

Inchoate rights of a constituent corporation, under pending condemnation proceedings, pass to the consolidated company upon consolidation.<sup>2</sup>

§ 77. **Miscellaneous Powers.** — It has been held that a corporation which by its charter has power to "unite with any

*Trester v. Missouri, etc. R. Co.*, 33 Neb. 171 (1891), (49 N. W. Rep. 1110); *Toledo, etc. R. Co. v. Dunlap*, 47 Mich. 456 (1882), 11 N. W. Rep. 271, 5 Am. & Eng. R. Cas. 378; *Boston, etc. R. Co. v. Midland R. Co.*, 1 Gray (Mass.) 359 (1854).

In *Re Trenton St. Ry. Co.* (N. J. 1900), 47 Atl. Rep. 819, it was held that even a *de facto* consolidated corporation may exercise the right of eminent domain if its constituents have such right.

The right to condemn lands is sometimes expressly conferred upon the consolidated corporation in the consolidation act.

*Michigan*: P. A. 1901, p. 117.

*New Jersey*: R. R. Law, par. 341,

§ 2.

<sup>1</sup> *Abbott v. New York, etc. R. Co.*, 145 Mass. 453 (1888), (15 N. E. Rep. 91).

<sup>2</sup> Proceedings instituted by a railroad company to acquire lands, by condemnation, for its road, in which commissioners have made their report and award of damages, from which the landowner has appealed, do not become void *ab initio* nor abate, by reason of the consolidation and merger of the condemning company with another railroad company, forming a new corporation; but the rights in the land acquired by the condemnation proceedings survive and pass to the new corporation, and it may be lawfully substituted as appellee in the appellate court and the case then proceed to trial. *Day v. New York, etc. R. Co.*, 58 N. J. L. 677 (1896), (34 Atl. Rep. 1081).

See also *California Central R. Co. v. Hooper*, 76 Cal. 404 (1888), (18 Pac. Rep. 599).



other company" by consolidating with another corporation exhausts the power, and it does not pass, with other powers and privileges, to the consolidated corporation.<sup>1</sup> The right of further consolidation is, however, sometimes expressly conferred in consolidation statutes.<sup>2</sup>

A consolidated corporation may apply the amount received from calls upon subscriptions to one constituent company in payment of the debts of another;<sup>3</sup> may compromise and settle claims against any constituent company and maintain an action to enforce the settlement;<sup>4</sup> may exercise the power of a constituent corporation to charge a fixed rate for transportation<sup>5</sup> and, generally, may enjoy and exercise any rights and powers conferred by the consolidation act.<sup>6</sup>

<sup>1</sup> *Morrill v. Smith County*, 89 Tex. 529 (1896), (36 S. W. Rep. 56).

<sup>2</sup> *Idaho*: Laws 1901, p. 214.

*North Dakota*: Rev. Codes 1899, § 2954.

*Washington*: Ballinger's Anno. Code & Stat. § 4304.

*Wisconsin*: Stat. 1906, vol. 3, § 1833.

<sup>3</sup> *Cooper v. Shropshire Union R., etc. Co.*, 13 Jur. 443 (1849), (6 Eng. Railw. Cases, 136).

<sup>4</sup> *Paine v. Lake Erie, etc. R. Co.*, 31 Ind. 283 (1869).

<sup>5</sup> *Fisher v. New York Central, etc. R. Co.*, 46 N. Y. 644 (1871), (7 Am. Rep. 397).

<sup>6</sup> Where a consolidation act provided that the new company should have the powers, rights and franchises conferred upon two or more railroad corporations in case they should bear such relation to each other as to admit the passage of cars over their roads continuously, it was held that such corporations having the power to acquire and hold land, might confer that power upon the consolidated company if it came within the proviso stated. *Georgia, etc. R. Co. v. Wilks*, 86 Ala. 478 (1888), (6 So. Rep. 34).

Generally as to the right of consolidated corporations to acquire title

to land see *Matter of Prospect Park, etc. R. Co.*, 67 N. Y. 371 (1876); *Georgia Pac. R. Co. v. Gaines*, 88 Ala. 377 (1889), (7 So. Rep. 382).

Miscellaneous statutory provisions relating to powers and privileges of consolidated corporations are as follows: Consolidated company may take, hold and dispose of stocks and bonds acquired by consolidation (*Ohio*. Bates' Anno. Stat. 1906, § 3384 A). Corporation formed by consolidation of domestic and foreign railroads may hold and own necessary real estate in adjoining State (*Missouri*. Anno. Stat. 1906, § 1060). Land grants pass to consolidated company (*Wisconsin*. Laws 1899, p. 291). Consolidated company acquires no extraordinary powers not enjoyed by each of constituents (*South Carolina*. R. S. 1893, § 1624). Consolidated company cannot change location of road which has received municipal aid (*Illinois*. R. S. 1906, § 39, p. 1572). Consolidated company has no powers and privileges which could not be possessed by corporation originally organized under the act (*Michigan*. P. A. 1899, p. 451, § 29). Corporate existence of consolidated company limited to ninety-nine years (*Louisiana*. Const. & Rev. Laws 1904, p. 1487). In addition to

It has been held that a consolidated corporation has no power to declare dividends upon its stock out of the earnings, before consolidation, of a corporation absorbed by it, nor to declare dividends upon the stock of the merging corporation out of its own earnings.<sup>1</sup>

A corporation formed by the merger of a banking corporation with a trust company does not succeed to the right of the former to act as executor of a will where the testator died after the consolidation took place.<sup>2</sup>

general powers, consolidated company enjoys rights, etc. of each of its constituents (*New York. Business Corp. Law* (amended to 1907), § 10).

<sup>1</sup> *Chase v. Vanderbilt*, 37 N. Y. Super. Ct. 334 (1874).

<sup>2</sup> *In re Stikeman's Will*, 96 N. Y. Supp. 460 (1905), (48 Misc. Rep. 156): "The will was made before there was any suggestion of merger between the two companies, and therefore it could not have been in contemplation of the willmaker at the time of the execution of his testamentary instrument. It is urged that all that the law permitted a corporation to do must be presumed to be in the mind of the trustmaker, but this, I think, would be straining the rule as to presumption beyond its legitimate purpose. We are to gather, if we can, the intention of the testator. We find him appointing a strictly and purely banking corporation as his executor

and trustee. This corporation has gone out of existence, its capital stock has been retired, it has become part of the Title Guarantee & Trust Company, and all its assets (whatever they may have been) are now subject to all the liabilities and obligations of the Title Guarantee & Trust Company, whether such obligations have arisen under the banking side of their business or under the title and mortgage insurance side. There was no vested or inchoate right obtained by the Manufacturers' Trust Company by reason of its having been named as executor in the will. This right to administer became vested and inchoate only upon the death of the testator, and at that time the corporation named was not in existence, had no capital stock, nor any official existence as a distinct corporation."

## CHAPTER VIII

## OBLIGATIONS OF CONSOLIDATED CORPORATION

I. *Direct Obligations*

- § 78. Constitutional Limitations.
- § 78a. Consolidated Corporation Liable upon its Own Obligations.
- § 79. As a General Rule Consolidated Corporation directly assumes all Obligations of Constituents.
- § 80. Obligation to perform Public Duties of Constituents.
- § 81. Liability of Consolidated Company to Bondholders and Preferred Stockholders of Constituents. Other Special Contracts.
- § 82. Liability for Torts of Constituents.
- § 83. Rule of Liability inapplicable to Consolidation after Foreclosure Sale.

II. *Liens*

- § 84. Conventional and Statutory Liens.
- § 85. Equitable Liens.

III. *Remedies of Creditors of Constituent Corporations*

- § 86. Remedy of Creditors against Consolidated Corporation — At Law.
- § 87. Remedy of Creditors — In Equity.
- § 88. Remedy against Constituent Corporation if not dissolved.
- § 89. Effect of Consolidation upon Pending Suits.
- § 90. Procedure regarding Pending Suits.
- § 91. Allegation and Proof of Consolidation.

I. *Direct Obligations*

§ 78. **Constitutional Limitations.** — Upon principles elsewhere considered, the obligations of a consolidated corporation, as a new and distinct corporation, are determined by the constitutional provisions and statutes in force at the time of its creation and not by those existing at the time of the creation of its constituent companies.<sup>1</sup> Thus the Supreme Court of the United States, in a leading case, held that a constitutional provision that "no special privileges shall ever be granted that may not be altered, revoked or repealed by the general assembly," entered into an act under which railroad companies

<sup>1</sup> See *ante*, § 71: "*Constitutional Limitations upon Grants of Privileges and Immunities.*"

had consolidated and rendered the consolidated corporation subject to the obligation — imposed by a later statute — of carrying passengers at a reduced rate of fare, which would not have been binding upon its constituent companies.<sup>1</sup>

§ 78a. **Consolidated Corporation Liable upon its Own Obligations.** — When consolidation has been effected two classes of obligations must be met by the consolidated corporation:

- (1) Its own obligations;
- (2) The obligations of its constituents.

Whatever may be the form in which consolidation takes place the consolidated corporation stands as a distinct corporate entity and, like any other corporation, is responsible for its own acts and omissions. And where the effect of the consolidation is the creation of a new corporation it must pay the franchise tax or incorporation fees required by a constitutional provision in the case of the organization of a corporation, notwithstanding its constituents may have already paid similar fees.<sup>2</sup>

§ 79. **As a General Rule Consolidated Corporation directly assumes All Obligations of Constituents.** — Consolidation statutes generally provide that all rights of creditors and all liens upon the property of constituent corporations shall continue unimpaired after consolidation, and that their debts, duties and liabilities shall attach to the consolidated company and be enforceable against it, to the same extent and by the same process as if they had been contracted by it.<sup>3</sup>

<sup>1</sup> *Shields v. Ohio*, 95 U. S. 319 (1877). See also *Pick v. Northwestern R. Co.*, 6 Biss. (U. S.) 177 (1874).

Restrictions as to rate of fare in charters of original companies bind consolidated corporation. *Campbell v. Marietta, etc. R. Co.*, 23 Ohio St. 168 (1872).

<sup>2</sup> *State v. Lesuer*, 145 Mo. 322 (1898), (46 S. W. Rep. 1075).

<sup>3</sup> The provision in the *New York* railroad consolidation act is as follows: Railroad Law § 73 (Birdseye's Rev. Stat. 1901, p. 2963): "The rights of all the creditors of, and all

liens upon the property of, either of such corporations, parties to such agreement and act, shall be preserved unimpaired, and the respective corporations shall be deemed to continue in existence to preserve the same, and all debts and liabilities incurred by either of such corporations shall thenceforth attach to such new corporation, and be enforced against it and its property to the same extent as if incurred or contracted by it."

Other similar but less elaborate statutes, relating to railroad consolidations (except as noted) are as follows:

A statute of this nature applies to successive consolidations and makes the final consolidated corporation liable for the debts of the original consolidating companies.<sup>1</sup>

In the absence of special statutory provision, moreover, when a new corporation is formed by the consolidation, under authority of law, of several distinct corporations and acquires their rights and faculties it must, as a necessary consequence, be subject to all the conditions and duties imposed by the law of their creation,<sup>2</sup> and is answerable for the debts and liabilities of each of such corporations,<sup>3</sup>—at least to

*Alabama:* Code 1896, § 1168; § 1151 (business corporations).

*Arizona:* R. S. 1901, par. 864, § 3.

*Arkansas:* Kirby's Dig. 1904, § 6735.

*California:* Pom. Civ. Code, 1901, § 473.

*Colorado:* Mills' Anno. Stat. 1891, § 607; § 628 (corporations generally).

*Connecticut:* Gen. Stat. 1902, § 3677; Pub. Acts 1903, p. 173, § 78 (business corporations).

*Delaware:* Laws 1903, p. 783, § 65.

*Illinois:* R. S. 1901, p. 1376, § 41.

*Idaho:* Civ. Code 1901, § 2178.

*Kansas:* Gen. Stat. 1905, § 6325.

*Kentucky:* Stat. 1903, ch. 32, § 556.

*Louisiana:* Rev. Laws 1904, pp. 1485, 1486.

*Maryland:* Pub. Gen. Laws 1904, p. 553, § 46.

*Michigan:* Comp. Laws 1897, § 6255.

*Minnesota:* Rev. Laws 1905, § 2898.

*Missouri:* Rev. Stat. 1889, § 2786 (manufacturing companies). See *Wells v. Missouri Edison El. Co.*, 108 Mo. App. 607 (1904), (84 S. W. Rep. 204).

*Montana:* Code & Stat. § 527 (mining companies).

*Nebraska:* Comp. Stat. 1907, § 2023.

*Nevada:* Stat. 1903, p. 139, § 44.

*New Jersey:* Gen. Corp. Act 1896, §§ 106, 107 (business corporations).

*New Mexico:* Comp. Laws 1897, § 3896.

*New York:* Business Corp. Law (amended to 1901), § 12.

*Ohio:* Bates' Anno. Stat. 1902, § 3384.

*Pennsylvania:* Bright. Purd. Dig. 1894, p. 1804, § 117; p. 1801, § 109.

*South Carolina:* Code 1902, § 2052.

*Tennessee:* Code 1896, § 1526.

*Utah:* R. S. 1898, § 341 (corporations generally).

*West Virginia:* Code 1899, ch. 54, § 53 (as amended by Acts 1901, ch. 108).

*Wyoming:* R. S. 1899, § 3204.

<sup>1</sup> *Birmingham R., etc. Co. v. Enslen*, 144 Ala. 343 (1905), (39 So. Rep. 74): "Under the provisions of the statute the debts and obligations of the constituent company follow it into the consolidation and become the debts and obligations of the consolidated company as much as if they had been originally created by it. And this is so as to every successive consolidation."

<sup>2</sup> *Chicago, etc. R. Co. v. Moffitt*, 75 Ill. 524 (1874).

<sup>3</sup> *Langhorne v. Richmond, etc. R. Co.*, 91 Va. 374 (1895), (22 S. E. Rep. 159): "The corporation which is created by the consolidation of other corporations, or the surviving corporation when another or others are

the extent of the property received from that particular corporation.<sup>1</sup>

merged into it, is ordinarily deemed the same as each of the corporations which formed it for the purpose of answering for the liabilities of the old corporation, and may be sued under its new name, or under the name of the surviving company, for their debts, as if no change had been made in the name, or in the organization of the original corporations."

*Louisville, etc. R. Co. v. Boney*, 117 Ind. 501 (1888), (20 N. E. Rep. 432, 3 L. R. A. 435): "The act of consolidation involves an implied assumption by the new company of all the valid debts and liabilities of the consolidating companies."

*Berry v. Kansas City, etc. R. Co.*, 52 Kan. 774 (1894), (36 Pac. Rep. 724, 39 Am. St. Rep. 381): "The debts of the original companies follow as an incident of the consolidation and become, by implication (in the absence of express provision), the obligations of the new corporation."

See also:

*United States v. Pullman Palace Car Co. v. Missouri Pac. R. Co.*, 115 U. S. 587 (1885), (6 Sup. Ct. Rep. 194); *Wabash, etc. R. Co. v. Ham*, 114 U. S. 587 (1885), (5 Sup. Ct. Rep. 1081).

*Alabama*: *Warren v. Mobile, etc. R. Co.*, 49 Ala. 582 (1873).

*Georgia*: *Atlantic, etc. R. Co. v. Johnson*, 127 Ga. 392 (1907), (56 S. E. Rep. 482); *Hawkins v. Central of Georgia R. Co.*, 119 Ga. 159 (1903), (46 S. E. Rep. 82); *Montgomery, etc. R. Co. v. Boring*, 51 Ga. 582 (1874).

*Illinois*: *Columbus, etc. R. Co. v. Skidmore*, 69 Ill. 566 (1873); *Chicago, etc. R. Co. v. Moffitt*, 75 Ill. 524 (1874); *Western, etc. R. Co. v. Smith*, 75 Ill. 496 (1874); *Swing v. American Glucose Co.*, 123 Ill. App. 156 (1905).

*Indiana*: *Indianapolis, etc. R. Co. v. Jones*, 29 Ind. 465 (1868), (95 Am. Dec. 654); *Columbus, etc. R. Co. v. Powell*, 40 Ind. 37 (1872).

*Michigan*: *Shadford v. Detroit, etc. R. Co.*, 130 Mich. 300 (1902), (89 N. W. Rep. 960).

*Missouri*: *Thompson v. Abbott*, 61 Mo. 176 (1875); *Manny v. National Surety Co.*, 103 Mo. App. 716 (1904), (78 S. W. Rep. 69).

<sup>1</sup> *Brum v. Merchants Mut. Ins. Co.*, 16 Fed. 140 (1883); *Harrison v. Arkansas Valley R. Co.*, 4 McCrary (U. S.) 264 (1882); *Harrison v. Union Pac. R. Co.*, 13 Fed. 522 (1882); *Chicago, etc. R. Co. v. Galey*, 141 Ind. 360 (1895), (39 N. E. Rep. 925); *Tompkins v. Augusta Southern R. Co.*, 102 Ga. 436 (1897), (30 S. E. Rep. 992); *United States Capsule Co. v. Isaacs*, 23 Ind. App. 533 (1899); *Morrison v. American Snuff Co.*, 79 Miss. 330 (1891), (30 So. Rep. 723, 89 Am. St. Rep. 598).

The qualification stated in the text, "at least to the extent of the property received from that particular corporation," is based upon the decisions in the above cases. But as said in a note to *Morrison v. American Snuff Co.*, 89 Am. St. Rep. 638 (1901): "The qualification seems to have been employed from an abundance of caution, rather than because of any well-settled rule limiting the liability of the consolidated company for the debts of its constituents to the extent of the property received from them, and is not referred to in the great majority of cases."

The difficulty of practically applying any such qualification is shown in the very recent decision of *Atlantic, etc. R. Co. v. Johnson*, 127 Ga. 397 (1907), (56 S. E. Rep. 482): "Some of the authorities say that when provision has not been made for paying existing debts and liabilities of one of the constituent companies the consolidated company is liable at least to the extent of the assets of the absorbed corporation. . . . It would

In *Indianapolis, etc. R. Co. v. Jones*,<sup>1</sup> the Supreme Court of Indiana said: "For the purpose of answering for the liabilities of the constituent corporations, the consolidated company should be deemed to be merely the same as each of its constituents; their existence continued in it, under the new form and name, their liabilities still existing as before and capable of enforcement against the new company in the same way as if no change had occurred in its organization or name."<sup>2</sup>

The statutory liability of a consolidated corporation for the debts and liabilities of its constituents cannot be impaired, as to outside creditors, by any stipulations in the consolidation agreement. Parties to the agreement, however, holding claims

put a severe burden upon a creditor of a corporation, whose demand, or the extent of whose damages, might amount to only a few dollars, when such corporation and another voluntarily merge into one and lose their previous identity, to hold that he cannot sue the original corporation because it has passed out of existence, and that he cannot sue the consolidated corporation and recover against it without alleging and proving that the consolidated company had received assets from the constituent company (or, as contended here, net assets) sufficient to cover any amount that the jury might award him. . . . This can hardly be law."

<sup>1</sup> *Indianapolis, etc. R. Co. v. Jones*, 29 Ind. 467 (1868), (95 Am. Dec. 654).

<sup>2</sup> In *Day v. Worcester, etc. R. Co.*, 151 Mass. 308 (1890), (23 N. E. Rep. 824), the Supreme Judicial Court of Massachusetts said: "When two corporations are consolidated, no doubt for most purposes they cease to exist, and the new corporation is a distinct person in the eye of the law, although it is their legal successor. But no fiction is necessary so far as the legislature sees fit to say that the new corporation shall be regarded as the same with one of the old ones or even alternately as the same with each; or,

more explicitly, that although the new corporation is a new person for the acquisition of new rights or the making of new contracts, the old corporations shall not be altogether ended, but shall continue under the new name so far as to preserve all their existing obligations unchanged."

In *Smith v. Los Angeles, etc. R. Co.*, 98 Cal. 210 (1893), (33 Pac. Rep. 53), the following language is used: "The consolidated corporation may, however, assume and make itself liable for the antecedent liabilities of such consolidating companies, and while such agreement does not without their consent bind creditors, yet suit brought by a creditor upon the demand so assumed against the corporation which has agreed to pay is of itself sufficient evidence of acceptance of the new charter in place of the old."

While the consolidation statute in this case may have justified the language used, it is by no means true that a constituent corporation as such is not freed from its obligations without the consent of its creditors. Where the effect of consolidation is the *dissolution* of the corporations consolidating, creditors may be obliged to look to their successor — the consolidated corporation.

against the consolidating corporations may bar themselves from proceeding against the consolidated corporation therefor.<sup>1</sup>

§ 80. **Obligation to perform Public Duties of Constituents.** — The public duties of corporations, whether imposed by express statutory provisions or assumed as the consideration of the grant of franchises, devolve, upon consolidation, upon the consolidated company.<sup>2</sup> They become, essentially, the obligations of that company, and the necessity for their continued performance bears no relation to the chartered life of the corporation to which they were originally attached. Thus it was held that upon the consolidation of gas-light companies the obligation imposed by the legislature on a consolidating company to furnish gas free of charge to a charity hospital,

<sup>1</sup> *Matter of Utica National Brewing Co.*, 154 N. Y. 277 (1897), (48 N. E. Rep. 521): "In the consolidation of corporations, pursuant to the provisions of the statute, the new corporation starts upon its existence freighted with the liabilities of the old companies and subject to the terms and conditions of the consolidation agreement, so far as they are not in conflict with the law. While it is not competent to do anything which would impair the rights of outside creditors, there is no reason why the parties to the consolidation agreement may not bind themselves to something deemed for the benefit of the new corporation, and that is what seems to have been done in this case. The manifest intention of the stockholders of the old companies, who united in making and signing the consolidation agreement, seems to have been to represent that their corporate properties and franchises vested in the new company freed from any burden of indebtedness. As to creditors not assenting to any such arrangement, this was quite unavailing; but as to themselves it should, and would, operate to bar their claims, while the other creditors were seeking payment from the assets of the corporation since become insolvent."

<sup>2</sup> *Tomlinson v. Branch*, 15 Wall. (U. S.) 465 (1872): "The keeping alive of the rights and privileges of the old company, and transferring them to the new company in connection with the property, indicates the legislative intent, that such property was to be holden in the same manner and subject to the same rights as before. The owners of the property were to lose no rights by the transfer, nor was the public to lose any rights thereby. Of course, these remarks do not apply to those corporate rights and franchises of the old company, which appertain to its existence and functions as a corporation. These became merged and extinct. But all its rights and duties, its privileges and obligations, as related to the public, or to third persons, remain, and devolve upon, the new company."

Where a consolidation of two railroad companies — one of which had a narrow-gauge road — was authorized by the railroad commission upon the express condition that the narrow-gauge line should be standardized and made a part of the main line, the consolidated company was bound to fulfil the condition.

*Mobile, etc. R. Co. v. State* (Miss. 1906), 41 So. Rep. 259.



adhered to the consolidated company without reference to the duration of the charter of the original company.<sup>1</sup>

An attempt in a consolidation agreement between quasi-public corporations to prevent the devolution of public duties upon the consolidated company and any attempt by the consolidated company to absolve itself from its obligations to the public, are against public policy. In *Peoria, etc. R. Co. v. Coal Valley Mining Co.*, the Supreme Court of Illinois said:<sup>2</sup> "When they accept their charters, it is with the implied understanding that they will fairly perform these duties to the public as common carriers of both persons and property, under the responsibility which that relation imposes. And this is a duty they cannot escape by neglect, refusal, or by agreement with other persons or corporations that they will disregard or refuse to perform them. These are duties they owe the public, and it was in consideration that they would be performed that their charters were granted. They have no power to absolve them-

<sup>1</sup> *Charity Hospital v. New Orleans Gas Light Co.*, 40 La. Ann. 388 (1888), (2 So. Rep. 433): "Through the same channel which led the defendant company to the right of ownership of all the property and rights of the former New Orleans Gas Light Company, it must be led and coerced to the discharge of the obligations which have been imposed on its author by the law which had created it and which authorized the organization of the new company."

A corporation formed by the consolidation of two boom companies must maintain the separate booms of each company and deliver logs at each as required in the original charters. *Gould v. Langdon*, 43 Pa. St. 365 (1862).

Under the federal income tax law a consolidated corporation was held liable for a tax upon "interest certificates," in the nature of dividend scrip issued by a constituent company before consolidation where the consolidation act preserved all rights of creditors and made the new corpora-

tion liable for the debts and obligations of the old companies. *Bailey v. Railroad Co.*, 22 Wall. (U. S.) 604 (1874).

As to liability of a consolidated company in South Carolina to assessment for expenses of railroad commissioners see *Charlotte, etc. R. Co. v. Gibbes*, 27 S. C. 385 (1887), (4 S. E. Rep. 49).

<sup>2</sup> *Peoria, etc. R. Co. v. Coal Valley Min. Co.*, 68 Ill. 489 (1873). In this case a consolidation agreement between several railroad corporations contained a reservation to one of the companies of the exclusive right to carry coal over the united railroads until the annual interest payment due said company had been discharged from the tolls, and it was held that such agreement, in restraint of competition, was contrary to public policy and not enforceable in equity; that the consolidated company became liable for the performance of the duties of the original companies as common carriers and that no contract could absolve it therefrom.

selves from performing these charter obligations, and any effort to do so by contract or otherwise is void."

**§ 81. Liability of Consolidated Company to Bondholders and Preferred Stockholders of Constituents. Other Special Contracts.** — The rule that a consolidated corporation is liable upon the obligations of its constituents applies to their sealed instruments and special contracts as well as to their simple debts.<sup>1</sup>

Bonds issued by a constituent corporation convertible into stock at the option of the holder confer upon him a valuable privilege, of which he cannot be deprived by consolidation. A holder of such convertible bonds is entitled to a fair opportunity to make his election, and cannot be relegated to the rights conferred by the consolidation agreement without it.<sup>2</sup> He may maintain an action against the consolidated company to recover damages for breach of the contract contained in the bond,<sup>3</sup> or, if consolidation has been effected on a basis of equality between the shares of the consolidated and the original company, he has the right to exchange his bonds for stock in the consolidated company.<sup>4</sup> A stockholder, however, by participating as such in a consolidation which renders impossible

<sup>1</sup> Generally, that a consolidated company is liable upon the contracts of its constituents: *Western Union R. Co. v. Smith*, 75 Ill. 496 (1874); *Eaton, etc. R. Co. v. Hunt*, 20 Ind. 457 (1863); *Columbus, etc. R. Co. v. Skidmore*, 69 Ill. 566 (1873); *St. Louis, etc. R. Co. v. Miller*, 43 Ill. 199 (1867). Also cases in note to § 79, *ante*.

<sup>2</sup> *Rosenkrans v. Lafayette, etc. R. Co.*, 18 Fed. 513 (1883).

<sup>3</sup> *John Hancock Mut. Life Ins. Co. v. Worcester, etc. R. Co.*, 149 Mass. 214 (1889), (21 N. E. Rep. 364).

<sup>4</sup> A statute authorizing the consolidation of two railroad companies provided that the consolidated corporation should "be subject to all the duties, restrictions, obligations, debts, and liabilities to which, at the time of the union, either of said corporations is subject," and that "all

claims and contracts . . . against either corporation may be enforced by suit or action . . . against the" consolidated corporation. The consolidation was made on the basis of equality between the shares of the two corporations. *Held*, that the holders of bonds of a constituent company convertible into stock were entitled to demand stock in the new corporation, as, for the purposes of the contract, the old corporation continued under the new name. *Day v. Worcester, etc. R. Co.*, 151 Mass. 302 (1890), (23 N. E. Rep. 824); *India Mut. Ins. Co. v. Worcester, etc. R. Co.* (Mass. 1890), 25 N. E. Rep. 975. See also *John Hancock Mut. Life Ins. Co. v. Worcester, etc. R. Co.*, 149 Mass. 214 (1889), (21 N. E. Rep. 364).

As to the right of holders of street railway bonds to convert them into stock of consolidated company under

the conversion of his bonds, may be held to have elected not to exchange.<sup>1</sup>

A statute authorizing the consolidation of railroad companies and providing that all the liabilities of the constituent companies "except mortgages" shall attach to the consolidated company, does not prevent an action by a mortgage bondholder against the consolidated company. The statute confines the *lien* to the mortgaged property, but does not debar the bondholder from enforcing his demand directly against the consolidated company without availing himself of the mortgage security.<sup>2</sup>

A consolidated corporation is the representative of all its constituents, and is liable to the stockholders of any one of them upon a contract of such corporation relating to the payment of dividends upon its preferred stock.<sup>3</sup>

While a holder of cumulative preferred stock in a corporation upon which dividends have been earned, but not declared and paid because surplus earnings have been expended in the acquisition of property, does not stand, upon the consolidation of such corporation with others, in the position of a technical creditor, his right is in the nature of a claim against the constituent company which may be enforced against the consolidated corporation. But his right to future dividends may be terminated by the consolidation.<sup>4</sup>

A corporation created by the consolidation of several insurance companies is liable upon their policies of insurance.<sup>5</sup>

Massachusetts statute of 1879, ch. 151, see *Parkinson v. West End St. R. Co.*, 173 Mass. 446 (1899), (55 N. E. Rep. 891).

<sup>1</sup> A person owning both stock and convertible bonds in a corporation did not exercise his option to have his bonds converted into stock when it was practicable, and acquiesced and participated in a consolidation by which it became impossible to secure the conversion, and it was held that he was bound by an election not to make the conversion. *Tagart v. Northern Cent. R. Co.*, 29 Md. 557 (1868).

<sup>2</sup> *Polhemus v. Fitchburg R. Co.*, 123 N. Y. 502 (1890), (26 N. E. Rep. 31), *affirming* 50 Hun (N. Y.), 397 (1888). The statute referred to was New York Laws 1869, ch. 917, § 5.

<sup>3</sup> *Boardman v. Lake Shore, etc. R. Co.*, 84 N. Y. 157 (1881). See also *Chase v. Vanderbilt*, 62 N. Y. 307 (1875). Compare *Prouty v. Lake Shore R. Co.*, 52 N. Y. 363 (1873).

<sup>4</sup> *Colgate v. U. S. Leather Co.* 67 Atl. Rep. 657 (N. J. Ch. 1907).

<sup>5</sup> *Franklin Life Ins. Co. v. Hickson*, 97 Ill. App. 387 (1901), *affirmed* 197 Ill. 117 (1902), (64 N. E. Rep. 248).

A surety company absorbing another corporation of the same nature is bound to fulfil its bonds and undertakings.<sup>1</sup>

Contracts of carriage embraced in mileage or trip tickets, issued by a constituent corporation, must be carried out by the consolidated company as if made by itself.<sup>2</sup> Covenants running with the land acquired from its constituents bind a consolidated company.<sup>3</sup>

The liability of a consolidated company upon the contracts of its constituents is precisely the same as that of the original company. Consolidation does not extend it. Thus the operation of a contract to haul cars on all lines owned or controlled by a railroad company is not extended, upon its consolidation, so as to include other roads which the consolidated company afterwards acquires.<sup>4</sup>

Where one life insurance company is consolidated with another, and it appears that the latter has been collecting premiums upon a policy of insurance which it had no power to issue, the amount of such premiums may be recovered from the consolidated company.

*Northwestern Nat. Life Ins. Co. v. Hare*, 26 Ohio Cir. Ct. Rep. 197 (1904).

<sup>1</sup> *Manny v. National Surety Co.*, 103 Mo. App. 716 (1904), (78 S. W. Rep. 69).

<sup>2</sup> *Tompkins v. Augusta Southern R. Co.*, 102 Ga. 436 (1897), (30 S. E. Rep. 992).

<sup>3</sup> *Mobile, etc. R. Co. v. Gilmer*, 85 Ala. 422 (1888), (5 So. Rep. 138).

A constituent company had agreed, in consideration of the grant of a right of way through certain land, to build its road-bed so as to protect the land from overflow, and it was held that the consolidated company was liable for damages caused by a breach of the agreement. *Sappington v. Little Rock, etc. R. Co.*, 37 Ark. 23 (1881).

Where a person had contracted to convey lands to a corporation, and afterward at its instance had organized another corporation, of which he

held the stock, to which he conveyed the lands, and the latter corporation thereupon consolidated with the former, it was held that notwithstanding the changes of title such person was entitled to the same rights and remedies against the consolidated company as he would have had against the corporation with which he had the contract.

*Cordova Coal Co. v. Long*, 91 Ala. 538 (1890), (8 So. Rep. 765).

<sup>4</sup> *Pullman Palace Car Co. v. Missouri Pacific R. Co.*, 115 U. S. 595 (1885), (6 Sup. Ct. Rep. 194): "The new company assumed, on the consolidation, all the obligations of the old Missouri Pacific. This requires it to haul the Pullman cars, under the contract, on all roads owned or controlled by the old company at the time of the consolidation, but it does not extend the operation of the contract to other roads which the new company may afterward acquire. The power of the old company to get the control of other roads ceased when its corporate existence came to an end, and the new company into which its capital stock was merged by the consolidation undertook only to assume its obligations as they then

A consolidated railroad company is bound to fulfil a contract of a constituent corporation to build, maintain and operate a switch running to a mill and, conversely, it is entitled to the benefit of an exemption from fire damage contained therein.<sup>1</sup>

§ 82. **Liability for Torts of Constituents.** — The usual consolidation statute declares that the consolidated corporation shall be answerable for the obligations of its constituent companies and thereby includes obligations arising *ex delicto* as well as *ex contractu*. And, without such statutory provision, the general rule is that the consolidated corporation is directly liable for the torts of its constituents. This liability is broad and includes both wrongful acts and negligence.<sup>2</sup>

stood. It did not bind itself to run the cars of the Pullman Company on all the roads it might from time to time itself control, but only on such as were controlled by the old Missouri Pacific. Contracts thereafter made to get the control of other roads would be the contracts of the new consolidated company, and not of those on the dissolution of which that company came into existence. It follows that the present Missouri Pacific Company is not required, by the contract of the old company, to haul the Pullman cars on the road of the St. Louis, Iron Mountain and Southern Company even if it does now control that road, within the meaning of the contract."

In *San Francisco v. Spring Valley Water Works*, 48 Cal. 493 (1874), a corporation furnished water to a city under a contract providing that, if more favorable terms were granted to any other corporation, they should be granted to it. This company was absorbed by another corporation, to which more favorable terms had been granted. It was held that the latter corporation was not bound to furnish water under the contract of the former, but was entitled to the more favorable terms given it before the absorption.

That the consolidated corporation takes the property and assumes the liabilities of its constituents in the exact condition in which they exist at the time of the consolidation, see *Franklin Life Ins. Co. v. Adams*, 90 Ill. App. 658 (1900).

<sup>1</sup> *Missouri, etc. R. Co. v. Carter*, 95 Tex. 461 (1902), (68 S. W. Rep. 159).

<sup>2</sup> In *Coggin v. Central R. Co.*, 62 Ga. 685 (1879), (35 Am. Rep. 132), the Supreme Court of Georgia said: "By consolidating with or absorbing the Macon & Western Railroad Company under the consolidation act the Central Railroad Company became liable to answer for a breach of duty by the former company toward a person who was rightfully upon one of its trains, and who, while being carried thereon, sustained a personal injury by reason of such breach."

In *State v. Baltimore, etc. R. Co.*, 77 Md. 492 (1893), (26 Atl. Rep. 865), the Court said: "The new corporation thus created was in reality the embodiment under another name of the two formerly existing," and held that the combining companies could not by any contract between themselves conclude the rights of third persons who had been injured by their torts.

A consolidated corporation is liable

Where, however, the consolidation statute provided that all judgments rendered against consolidating corporations either prior or subsequent to the consolidation should constitute liens upon the property derived from them, and that such corporations should continue in existence for the preservation of liens against them, it was held that the consolidation did not impair existing rights of action against such constituents and, consequently, that the consolidated com-

in damages to a riparian owner whose land is overflowed and injured in consequence of an obstruction of the stream caused by the wrongful manner in which a bridge was constructed by a constituent company. *Chicago, etc. R. Co. v. Moffitt*, 75 Ill. 524 (1874); *Penley v. Railroad Co.*, 92 Me. 59 (1898), (42 Atl. Rep. 233).

A consolidated railroad company is liable, without notice or demand for removal, for damages from a nuisance erected by a constituent company. *Jones v. Seaboard Air Line R. Co.*, 67 S. C. 181 (1903), (45 S. E. Rep. 188).

After having commenced the construction of an improvement on plaintiff's land, a corporation consolidated with another, which completed the improvement, all title thereto being transferred to the new company. It was held that the consolidated company and not the original company was liable for damages caused by the completion of the improvement by the consolidated company, although the original company still retained a corporate existence. *Day v. New Orleans, etc. R. Co.*, 37 La. Ann. 131 (1885).

Under a statute providing that a consolidated corporation shall be liable for all the debts and liabilities of its constituents existing or accrued prior to the consolidation, it has been held that it is liable upon a judgment rendered against a constituent corporation after consolidation on a cause of action for negligence arising

before that time. *Chicago, etc. R. Co. v. Ferguson*, 106 Ill. App. 356 (1902).

But in *Cotzhausen v. H. W. Johns Mfg. Co.*, 100 Wis. 473 (1898), (76 N. W. Rep. 622) it was held — apparently without due consideration — that a consolidated corporation does not by assuming all the debts, obligations and contracts of its constituents make itself liable for a tort theretofore committed by one of them.

See also :

*Alabama*: *Warren v. Mobile, etc. R. Co.*, 49 Ala. 582 (1873).

*Arkansas*: *St. Louis, etc. R. Co. v. Marker*, 41 Ark. 542 (1883).

*Georgia*: *Tompkins v. Augusta Southern R. Co.*, 102 Ga. 436 (1897), (30 S. E. Rep. 992).

*Indiana*: *Indianapolis, etc. R. Co. v. Jones*, 29 Ind. 465 (1868), (95 Am. Dec. 654); *Cleveland, etc. R. Co. v. Prewitt*, 134 Ind. 557 (1893), (33 N. E. Rep. 367); *Jeffersonville, etc. R. Co. v. Hendricks*, 41 Ind. 48 (1872); *Louisville, etc. R. Co. v. Summers*, 131 Ind. 241 (1892), (30 N. E. Rep. 873).

*Kansas*: *Berry v. Kansas City, etc. R. Co.*, 52 Kan. 759 (1893), (34 Pac. Rep. 805, 39 Am. St. Rep. 371).

*Michigan*: *Batterson v. Grand Trunk R. Co.*, 53 Mich. 125 (1884).

*Texas*: *Texas, etc. R. Co. v. Murphy* 46 Tex. 356 (1876).

*Virginia*: *Langhorne v. Richmond R. Co.*, 91 Va. 369 (1895), (22 S. E. Rep. 159).

pany was only liable for torts committed after the consolidation.<sup>1</sup>

§ 83. **Rule of Liability inapplicable to Consolidation after Foreclosure Sale.** — The rule that a consolidated corporation is liable for the debts of its constituents is inapplicable, with reference to the debts of the defunct company, in the case of a consolidation effected after the purchase of corporate property and franchises at a foreclosure sale.<sup>2</sup> The foreclosure sale has the effect of extinguishing the claims of general creditors. The new company takes the property subject only to the liens against it. A statute providing that a consolidated company shall be liable for the debts of each corporation entering the consolidation is not to be so construed as to revive the debts of a constituent company which have been shut off by foreclosure, and such an act would probably be unconstitutional, if retroactive in terms.<sup>3</sup>

<sup>1</sup> *Joseph v. Southern R. Co.*, 127 Fed. 606 (1904). In this case the statute also provided that the consolidated company should be subject to all the liabilities of the constituent companies. The difficulty with the conclusion of the Court is that it gives no effect to this provision. It required no statute to make the consolidated corporation liable for torts committed after the consolidation.

<sup>2</sup> *United States: Hoard v. Chesapeake, etc. R. Co.*, 123 U. S. 222 (1887), (8 Sup. Ct. Rep. 74); *Chesapeake, etc. R. Co. v. Miller*, 114 U. S. 184 (1885), (5 Sup. Ct. Rep. 813); *Hopkins v. St. Paul, etc. R. Co.*, 2 Dill. (U. S.) 396 (1872).

*Arkansas: Sappington v. Little Rock, etc. Co.*, 37 Ark. 23 (1881).

*Illinois: People v. Louisville, etc. R. Co.*, 120 Ill. 48 (1889), (10 N. E. Rep. 657); *Brufett v. Great Western R. Co.*, 25 Ill. 310 (1861).

*Michigan: Cook v. Detroit, etc. R. Co.*, 43 Mich. 349 (1880), (5 N. W. Rep. 390).

*Pennsylvania: Pennsylvania*

*Transp. Co.'s Appeal*, 101 Pa. St. 576 (1882); *Stewart's Appeal*, 72 Pa. St. 291 (1872).

*Texas: Gulf, etc. R. Co. v. Newell*, 73 Tex. 334 (1887), (11 S. W. Rep. 342, 15 Am. St. Rep. 788). In construing the provisions of the *Texas* statute relating to the sale of railroads and franchises in foreclosure proceedings the Supreme Court of Texas, in *Houston, etc. R. Co. v. Shirley*, 54 Tex. 139 (1880), said: "The plain intent of the statute is to transfer the road-bed, track, franchise and chartered rights entire to the purchaser and associates, upon their adopting the form of organization prescribed in the charter and complying with its other requirements; and to remit creditors unsecured by lien, to their remedy against such assets as pass to the trustees of the sold-out company."

*Wisconsin: Menasha v. Milwaukee, etc. R. Co.*, 52 Wis. 414 (1881), (9 N. W. Rep. 396).

<sup>3</sup> *Hatcher v. Toledo, etc. R. Co.*, 62 Ill. 477 (1872).

II. *Liens*

§ 84. **Conventional and Statutory Liens.** — The consolidation of corporations does not affect or in any way impair liens upon their property.<sup>1</sup> The consolidated corporation takes the property of its constituents burdened with all existing charges. Mortgages,<sup>2</sup> maritime liens,<sup>3</sup> and other liens — conventional and statutory — remain unaffected by consolidation

<sup>1</sup> *Hamlin v. Jerrard*, 72 Me. 80 (1881): "The consolidated company assumed the debts of its several parts and recognized the prior liens upon them. . . . There can be no loss of identity of the original companies in the consolidation, to the prejudice of the rights of prior creditors or to destruction of prior liens." See also *Eaton, etc. R. Co. v. Hunt*, 20 Ind. 457 (1863).

<sup>2</sup> A railway company which had mortgaged its road, consolidated with two other companies forming a new corporation. The consolidation act provided that the first corporation should not be relieved from any liability; that the several corporations should become one; and that all the liabilities of the several corporations should appertain to the united corporations. *Held*, that mortgage bonds of the first corporation, bought by the new corporation and afterward issued for its benefit for value, had not been extinguished, but were a claim against the property covered by the mortgage. *Shaw v. Norfolk County R. Co.*, 16 Gray (Mass.) 407 (1860). As to rights of holders of income bonds see *Rutter v. Union Pacific R. Co.*, 17 Fed. 480 (1883).

Where special assessments were levied by a municipality against the property of a street railway company and this company consolidated with others — the consolidated company assuming the obligations and burdens of its constituents — it was *held*, as between the municipality and the consolidated company, that the lien

of the assessments attached to the property of the latter corporation as an entirety. But with respect to the holder of a mortgage upon the property of one of the consolidating corporations against which there were no special assessments, it was further *held* that the lien of such mortgage could not be impaired by the consolidation, and that the assessments could not be made a lien upon the entire property of the consolidated company taking priority to such mortgage — that, in this view of the case, the assessment and mortgage liens attached to the specific properties upon which they were placed and that priorities could only be preserved by treating the properties as if no consolidation had taken place. *Lincoln St. R. Co. v. City of Lincoln*, 61 Neb. 109 (1901), (84 N. W. Rep. 802); *S. C. 67 Neb. 469* (1903) (93 N. W. Rep. 766).

<sup>3</sup> Where two corporations united their vessels and other property used in navigation, and formed a new corporation, and in the contract of consolidation made arrangements for the payment of the debts of one or both before any dividends should be declared on the new stock, it was *held* that the new corporation could not avail itself of the doctrine applicable to a purchaser without notice, and that a lien, three years and a half old, would be enforced against one of the vessels so transferred to the new corporation. *The Key City*, 14 Wall. (U. S.) 654 (1871). *Compare The Admiral*, 18 Law Rep. 91.



proceedings, and the rights of lien holders are neither increased nor diminished.

A consolidated corporation takes as a purchaser with notice, and cannot aver ignorance of a mortgage executed by one of its constituents, although unrecorded.<sup>1</sup>

Upon the principle that no change in the identity of corporations through consolidation can prejudice the rights of lien holders, it is held that repairs and improvements made by a consolidated company upon property — real or personal — mortgaged by a constituent before consolidation, are subject to the mortgage.<sup>2</sup> The necessity for this rule in the case of mortgaged chattels, *e.g.*, railway rolling stock, is apparent.

§ 85. **Equitable Liens.** — A consolidated corporation takes the property of its constituents subject to equitable, as well as other, liens.

A vendor's lien upon real estate for the unpaid purchase money is not affected by the consolidation of the purchasing corporation with another.<sup>3</sup> An obligation to convey lands

<sup>1</sup> Where by the consolidation of two railroad companies, another is created which, by the terms of the consolidation, acquires all of the property and franchises and assumes all the debts and liabilities of the two of which it is formed, and which become extinct by its creation, it takes such property subject to the debts of the original companies, and burdened with all liens upon it which were valid against those companies, and will not be permitted to aver ignorance of an unrecorded mortgage previously executed by one of the original companies. *Mississippi Valley Co. v. Chicago, etc. R. Co.*, 58 Miss. 846 (1881).

See also *North Carolina R. Co. v. Drew*, 3 Woods (U. S.), 691 (1874).

<sup>2</sup> *Hamlin v. Jerrard*, 72 Me. 80 (1881).

Improvements of a permanent nature and repairs made by a consolidated corporation upon property acquired from a constituent corporation and subject to a mortgage exe-

cuted by that company are covered by the mortgage and the mortgagee may be entitled to specific performance of a covenant for further assurance therein. *Williamson v. New Jersey Southern R. Co.*, 25 N. J. Eq. 13 (1874).

<sup>3</sup> *North Carolina R. Co. v. Drew*, 3 Woods (U. S.) 691 (1879). In this case, where a railroad subject to a vendor's lien was acquired by a consolidating company, the Court said: "This consolidation, by which the two companies joined their properties together, did not discharge the lien. The property of the Tallahassee Company was brought into the common concern with all preëxisting equities attaching thereto. The consolidated company having, as one of its component parties the Tallahassee company which held subject to the lien, cannot be regarded as a *bona fide* purchaser without notice." See also *Branch v. Atlantic, etc. R. Co.*, 3 Woods (U. S.) 481 (1879).

comes within the terms of a consolidation agreement transferring property subject to "all liens, charges and equities" and is binding upon the consolidated company. Such an obligation might have been equally binding, without such a provision, upon the principle that the property was charged with a trust to fulfil it and came into the hands of the consolidated company with notice.<sup>1</sup>

While creditors of consolidating corporations may follow the assets of their debtors into the hands of the consolidated corporation they have, in the absence of express provision, no lien thereon as against subsequent mortgagees or purchasers. Such a lien may, however, be created, and whether it exists in a particular case will depend upon the terms of the agreement of consolidation and of the statute under which consolidation takes place.<sup>2</sup> Where several railroad companies were consolidated and the consolidated company agreed to "*protect*" certain unsecured equipment bonds of a constituent company, it was held by Judge Gresham, in the Circuit Court of the United States,<sup>3</sup> that the holders of the equipment bonds

<sup>1</sup> *Union Pacific R. Co. v. McAlpine*, 129 U. S. 314 (1889), (9 Sup. Ct. Rep. 286): "The obligation of the Kansas Pacific Railway Company to execute the contract by a conveyance of the 25½ acre tract to the McAlpines passed with the property of the defendant, the Union Pacific Railway Company, upon the consolidation of the two companies under the latter name. Whenever property charged with a trust is conveyed to a third party with notice, he will hold it subject to that trust, which he may be compelled to perform equally with the former owner. The vendee in that case stands in the place of such owner. Without reference, therefore, to the articles of union and consolidation, the Union Pacific Railway Company would, on general principles, be held to complete the contract made with the Kansas Pacific Company; and the articles in specific terms recognize this obligation."

See also *Vilas v. Page*, 106 N.Y. 439 (1887), (13 N. E. Rep. 743).

<sup>2</sup> *Wabash, etc. R. Co. v. Ham*, 114 U. S. 595 (1885), (5 Sup. Ct. Rep. 1081): "But upon the consolidation, under express authority of statute, of two or more solvent corporations, the business of the old corporations is not wound up, nor their property sequestered or disturbed, but the very object of the consolidation, and of the statutes which permit it, is to continue the business of the old corporations. Whether the old corporations are dissolved into the new company, or are continued in existence under a new name and with new powers, and whether, in either case, the consolidated company takes the property of each of the old corporations charged with a lien for the payment of the debts of that corporation, depend upon the terms of the agreement of consolidation, and of the statute under whose authority that consolidation is effected."

<sup>3</sup> *Tysen v. Wabash, etc. R. Co.*, 15 Fed. 763 (1883), 11 Biss. (U. S.) 510.

acquired an equitable lien upon the property acquired by the consolidated company from such constituent, which took precedence of a mortgage thereof executed by the consolidated company. This decision was, however, reversed by the Supreme Court of the United States,<sup>1</sup> which held that the agreement to "protect" was merely a promise to pay the bonds as they matured, and that the equipment bondholders had no lien, equitable or otherwise, upon the property of the consolidated company. In a later decision, in a case brought by another holder of these equipment bonds against the same consolidated company, the Supreme Court of Ohio<sup>2</sup> declined to follow the Supreme Court of the United States but agreed with Judge Gresham, and held that the agreement to "protect" created an equitable lien, upon the principle that "where property is transferred upon condition that the grantee should pay some third person a debt, or sum of money, the latter acquires an equitable lien upon the property to the extent of the debt or sum which is to be paid to him."

### III. Remedies of Creditors of Constituent Corporations

§ 86. **Remedy of Creditors against Consolidated Corporation — At Law.** — A question has been raised whether a consolidated corporation can be sued in an action at law upon liabilities of its constituent companies or whether resort must

<sup>1</sup> *Wabash, etc. R. Co. v. Ham*, 114 U. S. 596 (1885), (5 Sup. Ct. Rep. 1081): "It was next contended that the stipulation in the agreement of consolidation that the bonds and debts therein specified of the former companies should 'be protected by the said consolidated company' created a lien in their favor. But it is only 'as to the principal and interest as they shall respectively fall due,' and 'according to the true meaning and effect' of the instruments or bonds which are the evidence of the debts, that it is stipulated that the debts shall 'be protected by the said consolidated company'; and the stipulation covers debts

secured by mortgage as well as unsecured debts. The agreement 'to protect' referring to the time of payment, and 'the true meaning and effect' of the equipment bonds having been to create only a personal and unsecured debt of one of the former companies, the words 'shall be protected' must have the same meaning which they ordinarily have in promises of men of business, 'to protect' drafts or other debts, not made or contracted by themselves, that is to say, a personal obligation to see that they are paid at maturity."

<sup>2</sup> *Compton v. Wabash, etc. R. Co.*, 45 Ohio St. 592 (1887), (16 N. E. Rep. 110).

be had to equity. It is, however, now well settled that consolidation confers all the rights, property and franchises of the old companies upon the consolidated company and subjects it to all their liabilities, and that an action at law may be brought against it and a personal judgment obtained for the debts and torts of its constituent companies.<sup>1</sup> The right to bring such action is placed upon the ground that, for the purpose of answering to their liabilities, the existence of the old companies is continued in the consolidated company;<sup>2</sup> and it is also held

<sup>1</sup> *Langhorne v. Richmond R. Co.*, 91 Va. 369 (1895), (22 S. E. Rep. 159), where the Court also said: "The question is not whether the consolidation compels a creditor to accept the defendant corporation as a new debtor against his will, or a person who has been injured to resort to a stranger for satisfaction, but whether it empowers the creditor of the person injured to resort, if he desires to do so, in the first instance, to the corporation which by the terms of the consolidation is made liable to him. The privity, some cases say, necessary to support this action is created by the statute authorizing the consolidation and the purchase and conveyance under it. Other authorities place the right to bring such an action on the ground that the effect of the consolidation is, as to the liabilities of the old company, not to dissolve the corporation which is the immediate debtor, but to continue its existence in the consolidated corporation. . . . Since by authority of law and the act of the parties the consolidated corporations are moulded into one with none of their rights impaired, and none of their responsibilities lessened, there is no good reason why the same proceedings may not be had against the new corporation as might have been had against the old to compel payment of liabilities. It avoids circuitry of action. It allows the party with whom the contract was made or to whom the injury was done to pro-

ceed directly against the corporation, which, by virtue of the consolidation proceedings, is made liable to it."

See also:

*Alabama*: *Warren v. Mobile*, etc. R. Co., 49 Ala. 582 (1873).

*Georgia*: *Coggin v. Central R. Co.*, 62 Ga. 685 (1879), (35 Am. Rep. 132).

*Illinois*: *Arbuckle v. Illinois Midland R. Co.*, 81 Ill. 429 (1876); *Columbus*, etc. R. Co. *v. Skidmore*, 69 Ill. 566 (1873); *St. Louis*, etc. R. Co. *v. Miller*, 43 Ill. 199 (1867).

*Indiana*: *Louisville*, etc. R. Co. *v. Boney*, 117 Ind. 501 (1888), (20 N. E. Rep. 432, 3 L. R. A. 435); *Indianapolis*, etc. R. Co. *v. Jones*, 29 Ind. 465 (1868), (95 Am. Dec. 654).

*Kansas*: *Berry v. Kansas City*, etc. R. Co., 52 Kan. 774 (1893), (36 Pac. Rep. 724, 39 Am. St. Rep. 371).

*Maryland*: *State v. Baltimore*, etc. R. Co., 77 Md. 489 (1893), (26 Atl. Rep. 865).

*Texas*: *Indianola R. Co. v. Fryer*, 56 Tex. 609 (1882); *Houston*, etc. R. Co. *v. Shirley*, 54 Tex. 125 (1880); *Missouri Pac. R. Co. v. Owens*, 1 Tex. Civ. Cas. par. 384 (1883).

Compare, however, *Whipple v. Union Pacific Co.*, 28 Kan. 474 (1882), where it was held that a consolidated corporation "is not liable for the debt of either constituent company unless it has in terms contracted to become so."

<sup>2</sup> *Indianapolis*, etc. R. Co. *v. Jones*, 21 Ind. 465 (1868); *Langhorne v. Richmond R. Co.*, 91 Va. 369 (1895),

that the statute fixing the liability and the proceedings thereunder create the privity between the new company and the creditors of the old, necessary to support the action.<sup>1</sup>

The consolidated company is bound by the admissions of a constituent corporation regarding its obligations made before consolidation, and evidence of the same is admissible in an action brought thereon against the new company.<sup>2</sup>

§ 87. **Remedy of Creditors — In Equity.** — A corporation holds its property as a trustee, first, to meet its obligations, and, afterwards, for the benefit of its stockholders. It cannot give away its property or enter a consolidation, the effect of which is to transfer its assets and terminate its existence, to the prejudice of its creditors.<sup>3</sup> A consolidated corporation is

(22 S. E. Rep. 159); *Houston, etc. R. Co. v. Shirley*, 54 Tex. 125 (1880). See also cases cited in preceding note.

<sup>1</sup> *New Bedford R. Co. v. Old Colony R. Co.*, 120 Mass. 397, 400 (1876) (sale): "In the absence of express provision, it cannot be inferred that it was the intention of the act to impair claims of third parties for existing liabilities, or to shorten the time within which the remedy must be pursued. The question is not whether the statute compels the creditor to accept the defendant corporation as a new debtor against his will, or an injured person to resort to a stranger for satisfaction, but whether it empowers the creditors or an injured person to resort, if he chooses, in the first instance, to the corporation which, by the terms of the statute, is made liable to him. And we are of opinion that it does, and that the privity necessary to support this action is created by the statute and the purchase and conveyance under it."

<sup>2</sup> *Philadelphia, etc. R. Co. v. Howard*, 13 How. (U. S.) 333 (1851): "It is further objected that the admission was not made by the defendants in this action but by the Wilmington and Susquehannah cor-

poration. It is true the action in the trial of which the admission was made, being brought before the union of the corporations, was necessarily in the name of the original corporation; but as, by virtue of the act of union, the Wilmington and Susquehannah Company, the Baltimore and Port Deposit Company, and the Philadelphia, Wilmington and Baltimore Company were merged in and constituted one body, under the name of the Philadelphia, Wilmington and Baltimore Railroad Company, it is very clear that at the time the trial took place in Cecil County Court, all acts and admissions of the defendant in that case, though necessarily in the name of the Wilmington and Susquehannah Company, were done and made by the same corporation which now defends this action."

<sup>3</sup> *Montgomery, etc. R. Co. v. Branch*, 59 Ala. 153 (1877): "A private corporation chartered to transact business is a trustee of its capital, property and effects — first for the payment of its creditors and afterward for the benefit of its stockholders. . . . If leaving its debts unpaid, its capital, property and effects are distributed among its stockholders, or transferred for their benefit to third persons who are not *bona fide* pur-

not a purchaser for value without notice, and a court of equity will treat the assets of a consolidating corporation as a trust fund for the benefit of its creditors and, upon its consolidation with unpaid debts, will pursue its assets and lay hold of them in the hands of the consolidated corporation and apply them for the payment of such debts.<sup>1</sup>

While a creditor has an action at law against the consolidated corporation upon the obligations of constituent companies, such remedy, as already noted, is not exclusive, and he may when he deems it to his advantage resort to equity and subject the property acquired from his debtor to the payment of the debt. Where, however, the consolidated corporation has sold the property so acquired to a *bona fide* purchaser for value a creditor cannot follow it.<sup>2</sup>

**§ 88. Remedy against Constituent Corporation if not Dissolved.** — Consolidation statutes sometimes provide that the

chasers, without notice, — and still more if the corporation be dissolved or become so disorganized that it cannot be made answerable at law, then a court of equity will pursue and lay hold of such property and effects, and apply them for the payment of what it owes to its creditors."

<sup>1</sup> In *Harrison v. Arkansas Valley R. Co.*, 4 McCrary (U. S.) 264 (1882), it was held that where several corporations are united in one, and the property of the old companies is vested in the new, the latter is liable in equity for the debts of the former, at least to the extent of the property received from them, and that if it is also liable at law, the latter remedy is not exclusive. The Court said (p. 267): "If a creditor of the original corporation sees fit to proceed in equity to subject the property of that corporation in the hands of the consolidated company, he has a clear right to do so. . . . We are of the opinion that, under such circumstances, the consolidated corporation is liable in equity for the debts of the original corporation, at least to the

extent of the value of the property received from it."

See also *Curran v. Arkansas*, 15 How. (U. S.) 304 (1853); *Montgomery, etc. R. Co. v. Branch*, 59 Ala. 139 (1877).

Compare, however, *Arbuckle v. Illinois Midland R. Co.*, 81 Ill. 429 (1876), where it was held that when a consolidated company becomes, by virtue of the consolidation, liable for the debts of the companies composing it, the creditor's remedy is complete and adequate at law, and that a court of equity will not assume jurisdiction to enforce it.

In *United New Jersey R., etc. Co. v. Happock*, 28 N. J. Eq. 261 (1877), it was held that corporations which have become consolidated into a new corporation assuming all their liabilities, are suable at law through the consolidated corporation; and that the fact that service of process cannot be had on them will not justify the resort to equity to enforce a strictly legal demand.

<sup>2</sup> *McMahon v. Morrison*, 16 Ind. 172 (1861), (79 Am. Dec. 418).

consolidating corporations shall not be dissolved but that their existence shall be continued for the purpose of winding up their affairs.<sup>1</sup> The purpose of these statutes is to preserve the rights of creditors, unchanged and unimpaired. Under such a statute<sup>2</sup> it is open to a creditor to enforce his demand either against the corporation whose debt it was or against the new corporation whose debt it becomes by virtue of the consolidation.<sup>3</sup> His remedies are concurrent and the recovery of a judgment against the old company does not affect his rights against the consolidated company. It merely changes the form of liability.

When consolidating corporations are continued in existence a creditor may institute insolvency proceedings against such a corporation, if such a remedy is available against corporations generally.<sup>4</sup>

<sup>1</sup> In *Whipple v. Union Pacific R. Co.*, 28 Kan. 474 (1882), where a consolidation statute provided that the consolidated corporation should not be liable for the debts of the consolidating corporations, which should continue in existence for the purpose of adjusting all demands against them, but that the consolidation should not prevent the enforcement of valid obligations against the property of each constituent in the hands of the consolidated company, it was held that a creditor of a constituent corporation could not maintain an action against the consolidated corporation until he had sued the constituent corporation and recovered judgment.

A street railway company which owed certain license fees to a municipality was absorbed by another corporation which assumed all its obligations. Held that the absorbed company continued to exist as a corporation so far as its existing creditors were concerned, and was liable for license fees due prior to the merger, but that it could not create liabilities after that time and was not liable for subsequent license fees. *City of New York v. Sixth Ave. R.*

*Co.*, 77 App. Div. (N. Y.) 367 (1902), (79 N. Y. Supp. 319).

Where the statutes authorizing consolidation provided that all judgments theretofore or thereafter obtained against the constituent corporations should be a lien upon the property of the consolidated company derived from them, and that the constituent companies should continue in existence to preserve the liens against them, it was held that a constituent corporation was liable for a tort committed prior to the consolidation, notwithstanding the consolidated corporation assumed all the liabilities of its constituents. *Jones v. Southern R. Co.*, 127 Fed. 606 (1904).

<sup>2</sup> *New York: Laws*, 1892, ch. 691, § 12.

<sup>3</sup> *Matter of Utica Nat. Brewing Co.*, 154 N. Y. 268 (1897), (48 N. E. Rep. 521). See also *Gale v. Troy, etc. R. Co.*, 51 Hun (N. Y.) 470 (1889), (4 N. Y. Supp. 295).

<sup>4</sup> *Platt v. New York, etc. R. Co.*, 26 Conn. 514 (1857). Whether State insolvency courts would have jurisdiction over interstate consolidated corporation, *quære. Ib.*

As to construction of Ohio statute

§ 89. **Effect of Consolidation upon Pending Suits.** — While the effect of consolidation may be the dissolution of the constituent corporations and the creation of a new company in their stead, it does not destroy them in such a sense as to abate actions brought by or against them and pending at the time of the consolidation, and compel the plaintiff to begin anew.<sup>1</sup> In *Shackleford v. Mississippi Central R. Co.*<sup>2</sup> the Supreme Court of Mississippi said: "The new company is the old company; it is each of the old companies. It is simply the onward flow of a stream which is formed by the uniting of two precedent streams."

As affecting the rights of creditors of the constituent corporations, the consolidated corporation should be regarded as

(R. S. § 3384), providing that consolidating corporations shall be deemed to continue in existence for the preservation of the rights of creditors, see *Bull v. Baltimore, etc. R. Co.*, 39 App. Div. (N. Y.) 236 (1899), (57 N. Y. Supp. 111).

<sup>1</sup> *United States: Edison El. Light Co. v. U. S. El. Lighting Co.*, 52 Fed. 300 (1892); *Edison El. Light Co. v. Westinghouse*, 34 Fed. 232 (1888).

*Alabama: In Birmingham R., etc. Co. v. Enslin*, 144 Ala. 343 (1905), (39 So. Rep. 74) a street railway company caused the death of a passenger and subsequently was absorbed by another corporation. Suit was brought against the consolidated corporation and during its pendency the latter corporation consolidated with a third. It was held that the pending suit was not affected by the last consolidation, and would proceed as if it had not taken place.

*Illinois: Chicago, etc. R. Co. v. Ashling*, 160 Ill. 373 (1896), (43 N. E. Rep. 373). See also *Franklin Life Ins. Co. v. Hickson*, 197 Ill. 117 (1902), (64 N. E. Rep. 248), *affirming* 97 Ill. App. 387 (1901).

*Indiana: Hanna v. Cincinnati, etc. R. Co.*, 20 Ind. 30 (1863).

*Michigan: Swartwout v. Mich. Air Line R. Co.*, 24 Mich. 389 (1872).

*Mississippi: Shackleford v. Miss. Cent. R. Co.*, 52 Miss. 159 (1876).

*Missouri: In Evans v. Interstate Rapid Transit Co.*, 106 Mo. 601 (1891), (17 S. W. Rep. 489), the Court said: "Ordinarily the effect of a consolidation of two or more corporations into one is a dissolution of all of them and the creation of a new company. But legal proceedings properly commenced against a corporation are not affected by the expiration of the charter before the determination of such proceeding. So where one corporation is consolidated with another while a suit is pending against it, the suit does not abate."

*Kinion v. Kansas City, etc. R. Co.*, 39 Mo. App. 382 (1899).

*Tennessee: Railroad Co. v. Evans*, 6 Heisk. 607 (1871).

*Compare Prouty v. Lake Shore, etc. R. Co.*, 52 N. Y. 366 (1873).

That consolidation does not abate condemnation proceedings, see *California Cent. R. Co. v. Hooper*, 76 Cal. 404 (1888), (18 Pac. Rep. 599); *Day v. New York, etc. R. Co.*, 58 N. J. L. 677 (1896), (34 Atl. Rep. 1081).

<sup>2</sup> *Shackleford v. Miss. Cent. R. Co.*, 52 Miss. 159 (1876).



continuing the existence of the old companies under a new name.<sup>1</sup> Consolidation statutes generally provide that consolidation shall not affect pending suits;<sup>2</sup> but, without such provision, a voluntary consolidation would not be considered as equivalent to the death of either of the constituent corporations so as to abate pending actions.<sup>3</sup>

§ 90. **Procedure regarding Pending Suits.** — It seems the better view that in a pending action, upon proof of the fact of consolidation being made, it may be proceeded with against the new company by amendment and that new process is not necessary to bring the consolidated company before the court. Technically speaking and for general purposes the consolidated company is a new corporation, but touching the business of the old companies and the rights of their creditors, it ought

<sup>1</sup> *Kinion v. Kansas City, etc. R. Co.*, 39 Mo. App. 382 (1889).

<sup>2</sup> *New York. Railroad Law*, § 73, (Birdseye's, R. S. 1901, p. 2963): "No action or proceedings in which either of such corporations is a party shall abate or be discontinued by such agreement or act of consolidation, but may be conducted to final judgment in the names of such corporations, or such new corporation may be, by order of the court, on motion, substituted as a party." For other similar provisions, see statutes referred in note to § 79, *ante*.

<sup>3</sup> *Baltimore, etc. R. Co. v. Musselman*, 2 Grant's Cas. (Pa.) 352 (1857): "But without any such provision as the above, in the law authorizing the consolidation, a court of justice would not consider the mere voluntary union of several corporations into one as equivalent to the death of either of them; or attribute to the law-making power an intention of enabling them to discharge their liabilities in such a summary way."

In *Kansas*, however, the exceptional view is taken that, since upon consolidation a constituent corporation is dissolved and ceases to exist as a corporation, an action brought by

or against it before consolidation cannot afterwards be prosecuted by or against it in its original name.

Thus in *Kansas, etc. R. Co. v. Smith*, 40 Kan. 192 (1888), (19 Pac. Rep. 636), the court said: "On May 31, 1886, when the *Kansas, Oklahoma and Texas Railway Company* consolidated with the other companies, it ceased to exist as a corporation. And everything which has since transpired upon the basis of the aforesaid railway company's being a corporation — indeed everything which has transpired in this case since May 31, 1886, is void. . . This case is where the original party has ceased to exist, has become defunct, is dead, and therefore not able either to prosecute or defend."

Also *Cunkle v. Interstate R. Co.*, 54 Kan. 194 (1894), (40 Pac. Rep. 184); *Chicago, etc. R. Co. v. Butts*, 55 Kan. 660 (1895), (41 Pac. Rep. 948); *Council Grove, etc. R. Co. v. Lawrence*, 3 Kan. App. 274 (1895), (45 Pac. Rep. 125).

See also *Indianola R. Co. v. Fryer*, 56 Tex. 609 (1882), where the court said that a judgment rendered against a constituent corporation after consolidation was a nullity.

properly to be regarded as the successor of the old companies under a new name; and to that extent it ought not to be regarded as a new corporation. If it is the same corporation under a different name, an additional summons is unnecessary.<sup>1</sup>

On the other hand, however, it was held by the Supreme Court of Georgia that it was error to permit the plaintiff to take judgment against a consolidated company, without taking proper steps to bring the new corporation, as such, before the court — including the issue of new process.<sup>2</sup>

A consolidated corporation having been substituted as defendant in place of a constituent company has the right to treat the pleadings filed by the original defendant as its own, and to avail itself of all exceptions to rulings reserved by such defendant prior to the substitution.<sup>3</sup>

**§ 91. Allegation and Proof of Consolidation.** — In order to charge a consolidated company or to enable it to recover in an action pending at the time of consolidation by or against a constituent company, the plaintiff must regularly allege the fact of consolidation and the successorship of the new

<sup>1</sup> *Kinion v. Kansas City, etc. R. Co.*, 39 Mo. App. 386 (1889): "Under this view it was not necessary to bring the defendant into court by a new summons, and the simple and direct act of substitution was right. If John Smith is sued, and during the pendency of the suit he has his name changed to John Jones, a claim that he, as John Jones, must be brought into court by additional summons would be somewhat novel. Practically that is this case."

In *Louisville, etc. R. Co. v. Summers*, 131 Ind. 241 (1892), (30 N. E. Rep. 873), an action against a railroad company for negligence, it was shown, *after a verdict* for plaintiff, that the defendant and certain other railroad companies had consolidated and formed a new company, which had succeeded to all the rights and liabilities of the consolidating companies. *It was held* that the trial court

properly substituted the consolidated company as defendant.

<sup>2</sup> *Selma, etc. R. Co. v. Harbin*, 40 Ga. 706 (1870).

It has been held that the consolidated company should not be substituted in place of the old company when the report of the referee has been made before consolidation. It was also held in the same case that the holder of preferred stock in a constituent company, in enforcing his claims thereon, stands in a different position from a creditor of such company. *Prouty v. Lake Shore, etc. R. Co.*, 52 N. Y. 363 (1873).

The substitution of the consolidated company in pending proceedings is often provided for in consolidation statutes. See statutes referred to in note to § 79, *ante*.

<sup>3</sup> *Louisville, etc. R. Co. v. Utz*, 133 Ind. 265 (1892), (32 N. E. Rep. 881).

company to the rights or liabilities of such constituent company and must prove the same, unless duly admitted. The court cannot take judicial notice of consolidation.<sup>1</sup>

Statutes providing that an allegation of corporate capacity shall be taken as true unless specifically denied do not apply to an allegation in a complaint that the defendant corporation consolidated with another company before the commencement of the suit.<sup>2</sup> An allegation in a complaint that certain railroad companies, authorized by law to consolidate, did consolidate and become one corporation under a certain name, is a sufficient averment of consolidation without setting forth in detail the steps taken by the constituent companies to bring about such result.<sup>3</sup> The facts concerning the consolidation should, however, be set forth with reasonable certainty,<sup>4</sup> although their absence from a petition would not occasion a reversal of judgment.<sup>5</sup>

Consolidation statutes sometimes provide that a copy of the articles of consolidation on file in the office of the Secretary of State, duly certified and authenticated, shall be *prima facie*

<sup>1</sup> *Southgate v. Atlantic, etc. R. Co.*, 61 Mo. 90 (1875). In *Brown v. Dibble*, 65 Mich. 520 (1887), (32 N. W. Rep. 656) it was held that it would not be presumed that a foreign constituent corporation had power to consolidate.

<sup>2</sup> *Koons v. Chicago, etc. R. Co.*, 23 Iowa, 493 (1867).

<sup>3</sup> *Collins v. Chicago, etc. R. Co.*, 14 Wis. 495 (1861), (80 Am. Dec. 789): "Now although these allegations in respect to the consolidation of the various companies are quite general we do not see how they could be made more specific, without setting forth in detail all the steps taken by the different companies to effect their consolidation and make it complete. . . . We therefore think the averments of the complaint should be deemed sufficiently explicit, on demurrer. They must be considered as equivalent to alleging that everything was done, and every step taken by the various companies to render their

acts of consolidation complete and effectual." As to pleadings concerning consolidation in *quo warranto* proceedings see *Commonwealth v. Atlantic, etc. R. Co.*, 53 Pa. St. 9 (1866).

<sup>4</sup> *Hubbard v. Chappell*, 14 Ind. 601 (1860); *Wright v. Bundly*, 11 Ind. 398 (1858); *Marquette, etc. R. Co. v. Langton*, 32 Mich. 251 (1875); *Langhorne v. Richmond R. Co.*, 91 Va. 369 (1892), (22 S. E. Rep. 159). In the last case the Court said (p. 375): "In this case, as the plaintiff had instituted his action to recover damages from the consolidated corporation for the injury alleged to have been done him by the corporation consolidated with it, it was necessary for him to allege generally the authority of the old companies to consolidate, and the fact that they had consolidated, and under what name, in order to show the liability of the new or consolidated company for the injury sued for."

<sup>5</sup> *Indianapolis, etc. R. Co. v. Jones* 29 Ind. 465 (1868), (95 Am. Dec. 654).

evidence of consolidation.<sup>1</sup> In the absence of such a statutory provision the existence of a consolidated corporation could, undoubtedly, be proved in the same manner as the existence of any other corporation — by showing the due execution and record of the consolidation agreement in pursuance of statutory authority, and acts of *user* thereunder.<sup>2</sup>

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## CHAPTER IX

### IRREGULAR AND INVALID CONSOLIDATIONS

§ 92. Attempted Consolidation — *Status* of Resulting Organization.

§ 93. Effect of Unlawful Consolidation.

§ 94. Effect of Irregular Consolidation.

§ 95. Who may attack Irregular Consolidation.

§ 96. Estoppel to deny Regularity of Consolidation.

§ 97. Accounting after Attempted Consolidation.

§ 98. Fraud in Consolidation Agreement.

§ 92. **Attempted Consolidation — Status of Resulting Organization.** — When a consolidation of corporations has been attempted but the result of the proceedings, through some defect or want of power, has not been a corporation *de jure*, the rights

<sup>1</sup> "A copy of said agreement and act of consolidation, duly certified by the Secretary of the State under his official seal, shall be evidence in all courts and places of the existence of said new company and that the provisions of this act have been fully observed and complied with." *Connecticut*, Rev. Stat. 1888, § 3445. Other States have somewhat similar statutory provisions.

A copy of articles of consolidation, duly certified under the seal of the Secretary of State, is *prima facie* evidence of the existence of the consolidated corporation. *East St. Louis, etc. R. Co. v. Wabash, etc. R. Co.*, 24 Ill. App. 279 (1887). See also *Columbus, etc. R. Co. v. Skidmore*, 69 Ill. 566 (1873).

<sup>2</sup> In the trial of an action against an alleged consolidated corporation for the negligence of a constituent company a deed from the latter corporation to the former conveying all its property and reciting the fact of the consolidation, and an act of the legislature confirming the consolidation but not stating when it took place, taken in connection with the admission incident to the plea of the general issue — that the defendant existed as a corporation when it was filed — constitute competent evidence of consolidation and, being in the case, a charge that there is no evidence of consolidation is unwarranted.

*Zealy v. Birmingham R., etc. Co.*, 99 Ala. 579 (1892), (13 So. Rep. 118).

and obligations accruing will be determined by ascertaining whether a *de facto* corporation has been formed. Unless a consolidation statute, in force at the time of the proceedings,<sup>1</sup> authorized the proposed consolidation, the result was a nullity even if there was an attempt in good faith to consolidate followed by an assumption of corporate powers.<sup>2</sup> An attempt to do that which the law does not permit can produce no result that the law will recognize. A body which cannot become a corporation *de jure* cannot become a corporation *de facto*. Moreover, the mere *user* of corporate powers which

<sup>1</sup> The subsequent passage of a consolidation statute, not retroactive in terms, does not validate an illegal consolidation nor create a *de facto* corporation. *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153).

<sup>2</sup> *Whaley v. Bankers' Union of the World* (Tex. Civ. App., 1905) 88 S. W. Rep. 261: "An attempted consolidation, where no statute authorizes consolidation, is a nullity; and the corporate existence of a nominally consolidated corporation formed in the absence of legislative authority for such consolidation may be collaterally attacked, its acts and contracts are void, and it cannot be held liable for the debts of one of the corporations attempting to consolidate." Citing this section. See also *Boor v. Tolman*, 113 Ill. App. 322 (1904).

*American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153): "In order that there should be a *de facto* corporation two things are essential: First, there must be a law under which the corporation might lawfully be created; and second, a *user*. When the law authorizes a corporation, and there is an attempt, in good faith, to organize, and corporate functions are thereupon exercised, there is a corporation *de facto*, the legal existence of which cannot ordinarily be questioned col-

laterally. . . . Our attention is called to no case in which it is held that, in the absence of any general law or special charter or other law authorizing incorporation or consolidation, as the case may be, and also in the absence of subsequent legislative ratification, the juristic personality of a corporation or consolidated corporation is complete and conclusive against all the world except the sovereign power. For the reasons we have stated the supposed consolidated corporation of the States of Wisconsin, Minnesota and Illinois called the Chicago Freeport and St. Paul Railroad Company, is not, and never was, a corporation either *de facto* or *de jure*. The right of way contracts and the trust deed made to the appellant were and are invalid, and this because there was no corporation in existence with capacity to either obtain a right of way, or contract, or act or be bound."

An attempted consolidation of mining and manufacturing corporations under a statute authorizing the consolidation of railroad companies is without warrant of law and of no effect. And this conclusion is not affected by the fact that such corporations may have power to build railroads to carry their own products from their lands to near-by lines.

*Commonwealth v. Pennsylvania etc. R. Co.* 17 Phila. (Pa.) 609 (1884).

might have been lawfully acquired, without a *bona fide* attempt to acquire them by forming a consolidation, does not create a consolidated corporation *de facto* nor does an attempt to organize without *user* have that effect. All of these elements must unite to form a *de facto* corporation, — (a) a statute under which the proposed consolidation might have been effected, (b) a *bona fide* attempt to consolidate, and (c) a *user* of the corporate powers claimed.<sup>1</sup>

§ 93. **Effect of Unlawful Consolidation.** — As already noticed, the result of an attempted consolidation when no statute authorizes consolidation is a nullity, and the same result follows when the other elements of a *de facto* corporation are lacking. Accordingly, the corporate existence of a nominally consolidated corporation, formed in the absence of legislative authority for such a consolidation, may be collaterally attacked, its acts and contracts are void,<sup>2</sup> and it cannot be held liable for the debts of one of the corporations attempting to consolidate.<sup>3</sup> So it was held, where two corporations were consolidated, without legislative authority, that promissory notes executed by the consolidated organization for purposes beyond the powers of the constituent companies were not

<sup>1</sup> In *Methodist, etc. Church v. Pickett*, 19 N. Y. 482 (1859), it was said that the following elements were essential to the existence of a *de facto* corporation: "(1) The existence of a charter or some law under which a corporation, with the powers assumed, might lawfully be created; and (2) a *user* by the party to the suit of the rights claimed to be conferred by such charter or law." This statement has, however, been criticised as omitting the element of an *attempt to organize*. *Finnegan v. Norrenberg*, 52 Minn. 239 (1893), (53 N. W. Rep. 1150, 38 Am. St. Rep. 552, 18 L. R. A. 778). In *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 653 (1897), Judge Taft, in considering what attempts at consolidation created a corporation *de facto*, stated the following conclusion, which seems

subject to the same objection as that in *Methodist, etc. Church v. Pickett*, *supra*: "It may be safely stated as the rule, that when persons assume to act as a body, and are permitted by acquiescence of the public and of the State to act as if they were legally a particular kind of corporation, for the organization, existence and continuance of which there is express recognition by general law, such body of persons is a corporation *de facto*, although the particular persons thus exercising the franchise of being a corporation may have been ineligible and incapacitated by the law to do so."

<sup>2</sup> *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153).

<sup>3</sup> *Kavanaugh v. Omaha Life Assn.*, 84 Fed. 295 (1897).

binding upon them after such organization had been dissolved.<sup>1</sup> Where, however, after a valid consolidation of two corporations had been effected, the consolidated corporation thus created attempted to further absorb, without authority, a third corporation and, thereafter, executed a mortgage upon all its property, it was held that the illegality of the latter consolidation did not affect the mortgage lien upon the property of the first two corporations.<sup>2</sup>

A judgment obtained against a consolidated corporation which is thereafter declared illegal may be enforced against the constituent companies, upon the theory that they were the real defendants under the assumed name.<sup>3</sup> A constituent railroad corporation, after an illegal consolidation, is liable for injuries received by a passenger while upon its railroad, caused by the negligent operation of the railroad by the employees of the consolidated company.<sup>4</sup>

An attempted consolidation, without authority, does not terminate the existence of a corporation, and *non-user* of its franchises during the existence of the illegal organization does not forfeit them.<sup>5</sup>

§ 94. **Effect of Irregular Consolidation.** — If, upon the principles indicated, the result of an attempted consolidation is a

<sup>1</sup> Where two separate corporations were created to build railroads, they had no right to unite and conduct their business under one management; nor had they a right to establish a steamboat line to run in connection with the railroads. Notes given for the purchase of the steamboat cannot be recovered upon. So held in *Pearce v. Madison, etc. R. Co.*, 21 How. (U. S.) 441 (1858).

<sup>2</sup> *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595).

<sup>3</sup> *Ketcham v. Madison, etc. R. Co.*, 20 Ind. 260 (1863).

<sup>4</sup> *Latham v. Boston, etc. R. Co.*, 38 Hun (N. Y.), 267 (1885): "The defendant was one of the constituent companies out of which the association was formed which was entitled to be a new company. As this

association has been adjudged to have had no legal capacity to exist as a corporation, it follows, as was also adjudged, that the individual entity of the defendant was not merged in it. Therefore, the defendant remained as an actor and participator in the association which did operate the railway, and thus one of the parties by whose negligence was injured. As such it was severally liable as one of the wrong-doers."

<sup>5</sup> *State v. Crawfordsville, etc. Turnpike Co.*, 102 Ind. 283 (1885), (N. E. Rep. 395).

An attempted consolidation without legislative authority does not work the dissolution of a corporation.

*Topeka Paper Co. v. Oklahoma Pub. Co.*, 7 Okla. 220 (1898), (54 Pac. Rep. 455).

corporation *de facto*, the general rule that the existence of such a corporation cannot be made the subject of collateral attack is applicable.<sup>1</sup> As said by the Supreme Court of the United States in the *Pacific Railroad Removal Cases*:<sup>2</sup> "The organization of the company under the consolidation proceedings makes it, at least, a corporation *de facto* and the legality of its constitution will not be inquired into collaterally."

Thus, after consolidation has taken place, it is no defence to an action brought upon an obligation given to the consolidated company that prescribed formalities were omitted in the consolidation proceedings.<sup>3</sup> Upon similar principles, it has been held that the existence of a *de facto* consolidated corporation cannot be attacked in an action of ejectment in order to disprove title in a plaintiff who claims through such corporation.<sup>4</sup>

§ 95. **Who may attack Irregular Consolidation.** — The State may directly attack the regularity of the organization of a

<sup>1</sup> *Pacific Railroad Removal Cases*, 115 U. S. 15 (1885), (5 Sup. Ct. Rep. 1113); *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 642 (1897); *Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*, 67 Fed. 49 (1895). Also, *Washburn v. Cass County*, 3 Dill. (U. S.) 251 (1875); *Leavenworth County v. Chicago, etc. R. Co.*, 25 Fed. 219 (1885).

In *City of Belleville v. Indianapolis, etc. R. Co.*, 49 Ill. App. 301 (1892) it was held that where it appeared that from the time a certificate of consolidation had been filed with the Secretary of State the corporation purporting to have been created had acted as a consolidated corporation, the effect of the consolidation if regular was to create a new corporation *de jure*, and if irregular, a corporation *de facto*.

<sup>2</sup> *Pacific Railroad Removal Cases*, 115 U. S. 15 (1885), (5 Sup. Ct. Rep. 1113).

<sup>3</sup> Where a party executed and delivered his promissory note to a consolidated organization which was

afterwards assigned by it, it was held in an action upon such note by the assignee against the maker, that the defendant, by executing his note to the corporation, thereby admitted its corporate existence, and, in order to avoid a payment for want of a party with whom to contract, he must prove that no such body existed in fact; and that under a plea of *null tiel corporation* where an organization in fact, and a user is shown, the existence of the corporate body is proved. *Mitchell v. Deeds*, 49 Ill. 416 (1867), (95 Am. Dec. 621).

See also *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 642 (1897); *Branch v. Jesup*, 106 U. S. 468 (1882), (1 Sup. Ct. Rep. 495).

<sup>4</sup> Where title is traced through a consolidated corporation which is not a party to the record and with which the defendant has no privity, proof of its existence as a corporation *de facto* by the articles of incorporation duly made is sufficient *prima facie*. *Tarpey v. Deseret Salt Co.*, 5 Utah 494 (1888), (17 Pac. Rep. 631).



*de facto* consolidated corporation in *quo warranto* proceedings.<sup>1</sup>

A subscriber to the stock of a constituent corporation, when sued by the consolidated corporation upon his subscription contract, may show the omission of some statutory condition precedent in the consolidation proceedings.<sup>2</sup> This is an exception to the rule against the collateral attack of *de facto* corporate existence and is justified by the relation of the parties.

The decision of the Supreme Court of Michigan, in *Brown v. Dibble*,<sup>3</sup> which, if well founded, practically nullifies the rule, cannot, however, be sustained upon the same ground. In that case it was held that when a consolidated corporation seeks to enforce rights against third persons, as the successor of its constituents, the question can be raised whether it has, in fact, been duly organized and has succeeded to the rights claimed.

The rule, however, that the existence of a consolidated corporation cannot be collaterally attacked is inapplicable when the consolidation is fraudulent.<sup>4</sup>

<sup>1</sup> *State v. Vanderbilt*, 37 Ohio St. 590 (1882); *Commonwealth v. Atlantic, etc. R. Co.*, 53 Pa. St. 9 (1866).

<sup>2</sup> Thus, where the consolidation act provided for the consolidation of corporations upon the approval of the agreement of consolidation by the constituent corporations, and required the election of a board of directors of the consolidated corporation as a condition to its succession to the rights and privileges of the constituent corporations, it was held that it might be shown by a subscriber, in action to enforce his subscription, that the consolidated corporation had not succeeded to such rights on account of its failure to comply with such condition. *Mansfield, etc. R. Co. v. Drinker*, 30 Mich. 124 (1874).

See also *Mansfield, etc. R. Co. v. Stout*, 26 Ohio St. 241 (1875); *Tuttle v. Michigan Air Line, etc. Co.*, 35 Mich. 249 (1877); *Mansfield, etc. R. Co. v. Brown*, 26 Ohio St. 223 (1875). The contrary is, however,

held in *Chicago, etc. R. Co. v. Stafford County*, 36 Kan. 128 (1887), (12 Pac. Rep. 593), (mandamus to enforce subscription), where the Court said: "As the plaintiff is a *de facto* corporation, under the decisions of this court its existence as such corporation can only be attacked in a direct proceeding brought for that purpose. Such matter cannot be inquired into collaterally."

<sup>3</sup> *Brown v. Dibble*, 65 Mich. 523 (1887), (32 N. W. Rep. 656): "Unless the consolidation is shown to be the legally created successor of the old Michigan Company it has no concern with its individual contracts with third persons; and if so identified it can only have . . . a right to recover by proof that all conditions of recovery have been complied with."

<sup>4</sup> *Jones v. Missouri-Edison El. Co.*, 144 Fed. 775 (1906): "Counsel for the defendants argue . . . that the existence of the consolidated corporation may not be collaterally

§ 96. **Estoppel to deny Regularity of Consolidation.** — While subscribers to the stock of constituent corporations may question the regularity of the consolidation, when sued by the consolidated company upon their subscriptions, a different principle may be applicable when creditors of that company seek to reach such subscriptions for the payment of its debts. In such a case subscribers who have acquiesced in the consolidation are estopped to question its validity.<sup>1</sup>

A *de facto* consolidated corporation is estopped from denying its corporate existence in order to avoid its obligations.<sup>2</sup>

assailed and annulled by a private party and that it may be successfully questioned by the State only, and he cites in support of this contention:

. . . But not one of these decisions holds that the perpetrator of a fraud or the abuser of a trust or their privies may shield themselves behind the inactivity of the State, quiet the conscience and escape the grasp of a court of chancery more successfully by appropriating the property of a *cestui que trust* by means of a consolidation of corporations than he may by a decree of foreclosure and sale (*Jackson v. Ludeling*, 21 Wall. 616 (1874), by a transfer of all the property of a corporation and its dissolution (*Ervin v. Oregon R. & Nav. Co.*, 20 Fed. 577 (1884), by a lease (*Meeker v. Winthrop Iron Co.* 17 Fed. 48 (1883)), or by any other legal device he may happen to adopt. The cases he cited have to do with transactions free from fraud, and while possibly pertinent to the charge in the bill that the consolidation was not authorized by law, they have no relevancy to the cause of action for fraud and breach of trust in the conception and execution of the consolidation. . .

The rule that the existence of a corporation may not be collaterally assailed by a private individual constitutes no bar to a suit by a minority stockholder to avoid for fraud or breach of trust a contract and act of consolidation of corpora-

tions and to restore the property to its former owner."

<sup>1</sup> *Hamilton v. Clarion, etc. R. Co.*, 144 Pa. St. 34 (1891), (23 Atl. Rep. 53).

<sup>2</sup> *United States: Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*, 67 Fed. 49 (1895).

*Illinois: Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 347 (1868), (95 Am. Dec. 595): "Where a company has issued its bonds and mortgage under the circumstances above detailed, the courts of every civilized country must hold an estoppel from denying its corporate existence, for such a defence is repugnant to every sentiment of justice and good faith. That this doctrine of equitable estoppel, or estoppel *in pais*, by which a person who has represented to another the existence of a certain state of facts, and thereby induced him to act on the faith of their existence, is concluded from averring against such person and to his injury that such representations were false, is as applicable to corporations as to natural persons, will hardly be denied."

A corporation which has, in effect, consolidated with another, is estopped to assert that the proceedings for consolidation were irregular, in an action against it to recover the amount of a judgment against the other corporation binding upon it if there was a consolidation. *Chicago, etc. R. Co.*

In *Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*<sup>1</sup> Judge Taft said: "It is too well established to need discussion that both a *de facto* corporation and the persons exercising the rights of stockholders in such a corporation are estopped to assert its unauthorized existence as a corporation to avoid a debt incurred by it in the actual exercise of corporate franchises and the doing of corporate business."

Creditors of a *de facto* consolidated corporation who have dealt with it as a corporation and whose claims have arisen after the issuance of mortgage bonds, are estopped from attacking the regularity of its organization for the purpose of invalidating the bonds.<sup>2</sup> As creditors they have no better standing than the bondholders.

Upon similar principles it would seem that creditors of an *illegal* consolidated corporation could not attack its validity in order to defeat the holders of prior securities. If the corporation is a nullity its bonds and unsecured debts are equally invalid.<sup>3</sup>

*v. Ashling*, 160 Ill. 373 (1896), (43 N. E. Rep. 373).

*Michigan*: In *Shadford v. Detroit etc. R. Co.*, 130 Mich. 300 (1902), (89 N. W. Rep. 960) it was held that a corporation created by the actual consolidation of several corporations, and which received and held their properties, could not deny its liability upon the obligations of a constituent corporation upon the ground that the consolidation was unlawful. See also *Howell v. Lansing, etc. R. Co.*, 146 Mich. 450 (1906) (109 N. W. Rep. 846). The difficulty with this decision is that the corporation in question seems not to have been even a *de facto* consolidated corporation. There was not only a want of statutory authority to consolidate but the whole transaction was rather in the form of a sale than of a consolidation.

*New Jersey*: *Williamson v. New Jersey Southern R. Co.*, 26 N. J. Eq. 398 (1875).

*Ohio*: *Adelbert University v.*

*Toledo, etc. R. Co.*, 3 Ohio N. P. 15 (1894).

<sup>1</sup> *Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*, 67 Fed. 49 (1895).

<sup>2</sup> *Louisville Trust Co. v. Louisville, etc. R. Co.*, 84 Fed. 539 (1898), reversed on other grounds, 174 U. S. 674 (1899), (19 Sup. Ct. Rep. 827), distinguishing *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153).

Also *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 648 (1897).

<sup>3</sup> *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 648 (1897) (*per* Taft J.): "Let us consider first the averment that the Toledo, St. Louis & Kansas City Railroad Company is neither a corporation *de jure* nor a corporation *de facto*. Can such a defence be urged by one purporting to be creditor of the pretended corporation? If the bonds are null and void because the corporation issuing them was a nullity, clearly the debts of the petitioners and the complain-

Principles of estoppel may also prevent the stockholders<sup>1</sup> and bondholders<sup>2</sup> of the consolidated corporation, and the constituent corporations<sup>3</sup> and their stockholders<sup>4</sup> from raising any questions as to the regularity of the consolidation.

ant are in no better condition and the court has nothing upon which to exercise its jurisdiction." See also *Louisville Trust Co. v. Louisville, etc. R. Co.*, 84 Fed. 539 (1898).

<sup>1</sup> It has been held that a subscriber for stock in a consolidated company cannot attack the validity of its organization on the ground that it embraces parallel roads. *Leavenworth County v. Barnes*, 94 U. S. 70 (1876); *Lewis v. City of Clarendon*, 5 Dill. (U. S.) 329 (1878), (6 Rep. 609).

Subscribers for stock in *consolidating* companies, can, however, enjoin a consolidation of parallel roads when prohibited by statute or constitutional provision. See *ante*, § 40: "*Enforcement of Provisions against Consolidation.*"

<sup>2</sup> *Wallace v. Loomis*, 97 U. S. 155 (1877): "In view of these facts, we think that the appellant is estopped from denying the corporate existence of the company whose bonds he thus holds, and by virtue of which he acquires a *locus standi* in the suit. Irregularities and even fraud committed in making the purchase authorized by the act, and failure to perform strictly all the requisites for changing the company's name, cannot avail the appellant, occupying the position he does in this suit, to deny the corporate existence of the Alabama and Chattanooga Railroad Company. He waived all such objections when he took the bonds, and came into court only as a holder and owner thereof. The irregularities on which he relies might, perhaps, have been sufficient cause for a proceeding on the part of the State to deprive the company of its franchises, or on the part of third persons who may have been injuri-

ously affected by the transactions. But neither the State nor any other persons have complained; and it is not competent for the appellant to raise the question in this collateral way, for the purpose of gaining some supposed advantage over other creditors of the same company, who have relied on its corporate existence in the same manner that he has done."

<sup>3</sup> A corporation which has voluntarily become consolidated with another, has participated in all the necessary proceedings in such consolidation, and has permitted the *de facto* corporation so formed to control its business and property and third parties to acquire rights and interests based on the existence of such *de facto* corporation, cannot sue to have such consolidation declared invalid by reason of irregularities in its formation. *Bradford v. Frankfort, etc. R. Co.*, 142 Ind. 383 (1895), (40 N. E. Rep. 471).

See also *Carey v. Cincinnati, etc. R. Co.*, 5 Iowa, 357 (1857); *Dimpfel v. Ohio, etc. R. Co.*, 9 Biss. (U. S.) 127 (1879).

<sup>4</sup> *Bell v. Pennsylvania, etc. R. Co.* (N. J. 1887), 10 Atl. Rep. 741; *Lewis v. City of Clarendon*, 5 Dill. (U. S.) 329 (1878), (6 Rep. 609).

In the latter case the Court said: "By subscribing for stock and issuing its bonds under the circumstances to the consolidated company the city is estopped in a suit upon such bonds from showing that the latter company is not a corporation *de jure*."

Where the validity of a consolidation has not been attacked by the State or a dissenting stockholder, a municipal corporation cannot question it by way of a defence to an action on

§ 97. **Accounting after Attempted Consolidation.** — While an attempted consolidation, without statutory authority, is *ultra vires* and no action will lie upon the agreement of consolidation, one corporation which has received under the agreement property of another can be compelled to make restitution thereof or to account for its value.<sup>1</sup> Thus, where a bill in equity brought to restrain an *ultra vires* consolidation was dismissed because of the voluntary rescission of the articles of consolidation, a cross bill praying for an accounting was permitted to stand, and the suit remained for the purpose of such accounting. In this case the Supreme Court of Mississippi said: "The decided weight of authority in England and America is that no action lies upon the invalid contract, that no decree can be made by a court of equity for its specific performance, nor can a recovery be had at law for its breach; but that, by proceeding in the proper court, the plaintiff may recover to the extent of the benefit received by the defendant from the execution of the agreement by the plaintiff."<sup>2</sup>

§ 98. **Fraud in Consolidation Agreement.** — Courts of equity will annul any scheme by which the stockholders of one corporation, after agreeing to consolidate their corporation with another, fraudulently seek to gain an advantage over the shareholders of the latter company. Thus, where one corporation after agreeing to a consolidation declared a scrip dividend and issued certificates of indebtedness therefor without the knowledge of the other corporation, which then went into the consolidation, it was held, in a suit in equity brought by the stockholders of the latter company, that the scrip was fraudulent and void and should be delivered up to be cancelled.<sup>3</sup>

bonds issued to a constituent corporation. *Washburn v. Cass County*, 3 Dill. (U. S.) 251 (1875).

It has been held, however, that the holder of bonds issued by a county to a railroad company, two days after an attempted consolidation with another company, was not estopped, as against the county, from asserting the invalidity of such consolidation. *Morrill v. Smith County*, 89 Tex. 529 (1896), (36 S. W. Rep. 56).

<sup>1</sup> For full consideration of the sub-

ject of *ultra vires* contracts and of the rights and duties of the parties thereto see *post*, ch. 22.

<sup>2</sup> *Greenville Compress Co. v. Planters Compress, etc. Co.*, 70 Miss. 676 (1893), (13 So. Rep. 879, 35 Am. St. Rep. 681).

<sup>3</sup> *Bailey v. Citizens Gas Light Co.*, 27 N. J. Eq. 196 (1876).

Equity, however, cannot *dissolve* a consolidated corporation upon the ground, alleged by a stockholder in a constituent corporation, that the

The consolidation of a corporation, effected by the majority stock interests through directors chosen by them against the protests of the minority, with another corporation likewise controlled by such majority interests, by the terms of which the preferred stock held by the minority is deprived of the greater part of its value, to the benefit of the stockholders of the second corporation, is a fraud upon the minority. It constitutes an abuse of the trust relation borne by the holders of the majority of the stock to the minority, and a breach of duty upon the part of the directors. The consolidation effected through such fraudulent scheme is voidable in equity at the suit of the minority stockholders and the courts may grant other effective relief.<sup>1</sup>

consolidation was for a fraudulent purpose, and not legally effected.

*Terhune v. Midland R. Co.*, 38 N. J. Eq. 423 (1884).

<sup>1</sup> *Jones v. Missouri-Edison El. Co.* 144 Fed. 765 (1906). In this case the United States Circuit Court of Appeals for the Eighth Circuit said (p. 771): "A combination of the holders of a majority or of three-fifths of the stock of a corporation to elect directors, to dictate their acts and the acts of the corporation for the purpose of carrying out a predetermined plan places the holders of such stock in the shoes of the corporation and constitutes them actual, if not technical, trustees for the holders of the minority of the stock. The devolution of power imposes correlative duty. The members of such a combination become in practical effect the corporation itself because they draw to themselves and use the power of the corporation. In a sale of its property, in a consolidation of the corporation with another, in every act and contract of the corporation which they cause they make themselves the trustees and agents of the holders of the minority of the stock because it is only through them that the latter may act or contract regarding the corporate property or pre-

serve or protect their interests in it. Such a majority of the holders of stock owe to the minority the duty to exercise good faith, care, and diligence to make the property of the corporation in their charge produce the largest possible amount, to protect the interests of the holders of the minority of the stock and to secure and deliver to them their just proportion of the income and of the proceeds of the property. Any sale of the corporate property to themselves, any disposition by them of the corporation or of its property to deprive the minority holders of their just share of it or to get gain for themselves at the expense of the holders of the minority of the stock, becomes a breach of duty and of trust which invokes plenary relief from a court of chancery."

A very different view of the obligations of majority stockholders to the minority in case of a consolidation is expressed in *Colgate v. United States Leather Co.*, 67 Atl. Rep. 663 (N. J. Ch. 1907): "The general rule under our decisions is that the individual stockholders are not trustees for each other, but each may, as a member of the general corporate body exercise his individual right and vote equally with the stockholders on the

A secret agreement between the promoters of a consolidation that the money advanced for the purchase of certain stock, necessary to effect the consolidation, should be a debt of the consolidated company, and be repaid by an issue of its bonds, is not binding upon the consolidated company and the proceeds of bonds so applied may be recovered.<sup>1</sup>

An arrangement for consolidation between two corporations having directors in common is not necessarily void; but the burden is upon such directors of showing that it is fair to all stockholders. If it is in any respect unfair to minority interests it may be set aside in equity.<sup>2</sup>

ratification of a contract in which he is interested, and ratification or adoption of the contract is valid, even if carried by his vote. . . . This right of the majority (statutory or other) either to originally direct or to affirm contracts or other proceedings in which the directors or the majority stockholders are interested is not, however, absolute but is subject to the necessary qualification that the majority, although they may deal with the assets of the company, cannot so deal with them as to divide those assets, more or less, between themselves, to the exclusion of the minority. . . . By this rule full practical protection, and all the protection they are entitled to, is given to the minority stockholders without resort to any principle of supposed trust relationship of one individual stockholder, or any combination of such individual stockholders, who constitute a majority, towards those who do not act with them and constitute a minority. To make the majority of the stockholders either directly or through their directors trustees of the minority, and obliged because they are in the majority to

conduct the business or affairs of the company, as in any respect the special trustees of the minority seems to me to be a misconception of trust relations."

For case of alleged fraudulent and *ultra vires* consolidation effected by majority stockholders in violation of right of minority, see *Stevens v. Missouri, etc. R. Co.*, 106 Fed. 771 (1901).

<sup>1</sup> *Trenton Pass. R. Co. v. Wilson*, 55 N. J. Eq. 273 (1897), (37 Atl. Rep. 476).

<sup>2</sup> *Dady v. Georgia, etc. R. Co.*, 112 Fed. 838 (1900). See also *post*, § 114, "*Voidable Sales*."

An agreement for the consolidations of two corporations has, however, been held neither void nor voidable at the option of a minority stockholder because the directors executing it were the common directors of both corporations. This decision was placed upon the ground that consolidation required the act of the stockholders, to which the directors' agreement was merely preliminary.

*Colgate v. U. S. Leather Co.* (N. J. Ch. 1907), 67 Atl. Rep. 657.

## CHAPTER X

## INTERSTATE CONSOLIDATIONS

§ 99. Consolidation of Corporations of Different States — How authorized.

§ 100. Construction of Interstate Consolidation Statutes.

§ 101. *Status* of Interstate Consolidated Corporation.

§ 102. Effect of Interstate Consolidation upon *Status* of Constituent Corporations.

§ 103. Management of Interstate Consolidated Corporation.

§ 104. Rights and Powers of Interstate Consolidated Corporation.

§ 105. Duties of Interstate Consolidated Corporation — Taxation.

§ 106. Citizenship of Interstate Consolidated Corporation.

§ 107. Foreclosure of Mortgages after Interstate Consolidation. Jurisdiction.

§ 99. **Consolidation of Corporations of Different States — How authorized.** — Consolidation statutes generally provide for the consolidation of domestic railroad and other carrier corporations with those of an adjoining State where the works of the several corporations, when united, will form a continuous or connected line. The connection between the railroads may in some States be by a bridge, in others by a ferry and in another by a tunnel.<sup>1</sup> One State, at least, has no general act permitting the consolidation of domestic railroad companies but authorizes the consolidation of any railroad company incorporated under its laws with any other corporation whose line of railroad "is situated wholly outside this State."<sup>2</sup> As already shown, State legislation authorizing the consolidation of such corporations is not a regulation of interstate commerce.<sup>3</sup>

The consolidation of domestic and foreign *business* corporations is not, as a rule, permitted by consolidation statutes applicable to that class of corporations.

§ 100. **Construction of Interstate Consolidation Statutes.** — Express legislative authority from each of the States creating the several corporations proposing to consolidate must be

<sup>1</sup> See *ante*, § 22: "*What Railroads may consolidate — Statutory Provisions.*"

<sup>2</sup> *Connecticut*: Gen. Stat. 1902, § 3674.

<sup>3</sup> See *ante*, § 19a: "*Authorization of Consolidation of Interstate Railroads not regulation of Interstate Commerce.*"



granted before a valid consolidation can take place. Any ambiguity in the terms of the grant will operate against the corporation and in favor of the public.

A legislative grant of authority to consolidate does not authorize consolidation with a foreign corporation unless such power is clearly expressed.<sup>1</sup> It has, however, been held that an act authorizing a domestic railroad corporation to consolidate with corporations operating roads in an adjoining State, authorizes a consolidation with a company operating, in an adjoining State, a road which extends into a third State.<sup>2</sup> Power to purchase stock in "any other connecting railroad" authorizes the purchase of the stock of a foreign connecting railroad,<sup>3</sup> and legislative consent to a purchase by "any railroad company" includes foreign as well as domestic railroad corporations.<sup>4</sup>

§ 101. **Status of Interstate Consolidated Corporation.** — A State may grant to a corporation of another State power to lease or purchase a railroad within its territory, and to maintain and operate it, without making such corporation a domestic corporation or a citizen of such State.<sup>5</sup>

<sup>1</sup> *American Loan, etc. Co. v. Minnesota, etc. R. Co.*, 157 Ill. 641 (1895), (42 N. E. Rep. 153). See also *Loughlin v. United States School Furniture Co.*, 118 Ill. App. 36 (1905); *Continental Trust Co. v. Toledo, etc. R. Co.*, 82 Fed. 642 (1897). In *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 456 (1873), it was held, in the analogous case of a lease, that power to lease to "any other corporation or otherwise" did not authorize a lease to a foreign corporation.

<sup>2</sup> *Adelbert College v. Toledo, etc. R. Co.*, 3 Ohio N. P. 15 (1894). See also *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595).

<sup>3</sup> *Pittsburgh, etc. R. Co. v. Keokuk, etc. Bridge Co.*, 131 U. S. 371 (1889), (9 Sup. Ct. Rep. 770); *Day v. Ogdensburg, etc. R. Co.*, 107 N. Y. 129 (1887), (13 N. E. Rep. 765).

<sup>4</sup> *Boston, etc. R. Co. v. Boston, etc.*

*R. Co.*, 65 N. H. 393 (1888), (23 Atl. Rep. 529): "Express consent is given to a purchase by 'any railroad company.' Taken without qualification, this clause includes foreign as well as domestic railroad corporations. The words 'any railroad' might be used in a connection and for a purpose which would show a restricted sense not including foreign companies. Here is no evidence of a purpose to exclude them."

<sup>5</sup> I. It is competent for a railroad company, when authorized by the State creating it, to accept a grant of authority from another State to extend its railroad into such State, and to receive a grant of powers to own or control, by lease or purchase, railroads of other corporations therein, and it may subject itself to such rules and regulations as may be prescribed by the second State. Such legislation is not regarded as within the

When corporations of different States desire to consolidate, and to acquire the rights and privileges of that relation, the consolidated corporation created by the necessary coöperative legislation is essentially different from a corporation created by the consolidation of domestic corporations. A corporation formed by the consolidation of corporations of different States, although it has the same shareholders, is designed to accomplish the same purpose, and has the same powers, in each State, is a separate and distinct corporation in each State and exists in each State as a domestic corporation.<sup>1</sup> In

constitutional inhibition against compacts between States. *St. Louis, etc. R. Co. v. James*, 161 U. S. 562 (1896), (16 Sup. Ct. Rep. 621); *Railroad Co. v. Harris*, 12 Wall. (U. S.) 82 (1870); *Copeland v. Memphis, etc. R. Co.*, 3 Woods (U. S.) 651 (1878).

II. The conclusive presumption for jurisdictional purposes, applicable to all corporations, that a corporation is composed of citizens of the State which created it, accompanies the corporation when transacting business in another State, and it may sue and be sued in the federal courts of such other State as a citizen of the State of its original creation. *St. Louis, etc. R. Co. v. James*, 161 U. S. 562 (1896), (16 Sup. Ct. Rep. 621); *Shaw v. Quincy Mining Co.*, 145 U. S. 444 (1892), (12 Sup. Ct. Rep. 935); *Interstate Commerce Com. v. Texas, etc. R. Co.*, 57 Fed. 948 (1893); *Myers v. Murray, etc. Co.*, 43 Fed. 695 (1890); *Miller v. Wheeler, etc. Co.*, 46 Fed. 882 (1891); *Copeland v. Memphis, etc. R. Co.*, 3 Woods (U. S.) 657 (1878). This doctrine of indisputable citizenship does not, however, extend so far as to make such a corporation a citizen of the second State even though it be there endowed with all the powers and privileges usually granted to domestic corporations. *St. Louis, etc. R. Co. v. James*, 161 U. S. 562 (1896), (16 Sup. Ct. Rep. 621). *Compare* *Southern R.*

*Co.*, Allison 190 U. S. 326 (1902), (23<sup>d</sup> Sup. Ct. Rep. 713); *Patch v. Wabash R. Co.*, 207 U. S. 277 (1907), (28 Sup. Ct. Rep. 80).

III. The second State may create a corporation of the same name as the corporation of the other State, and may declare that the same legal entity shall be a corporation of that State and shall be entitled to exercise within its borders, by the same officers, all its corporate functions. The decided weight of authority supports the view that the result of such legislation is not the creation of a single corporation, but two corporations of the same name having a different paternity and being citizens, respectively, of the States creating them. *Ohio, etc. R. Co. v. Wheeler*, 1 Black (U. S.) 286 (1861). See also *Muller v. Dows*, 94 U. S. 444 (1876); *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1885), (6 Sup. Ct. Rep. 1094); *Nashua, etc. R. Corp. v. Boston, etc. R. Corp.*, 136 U. S. 356 (1889), (10 Sup. Ct. Rep. 1004); *Racine v. Farmers Loan, etc. Co.*, 49 Ill. 348 (1868), (95 Am. Dec. 595); *Missouri Pac. R. Co. v. Meeh*, 69 Fed. 755 (1895), (30 L. R. A. 250).

*Contra*, *Railroad Co. v. Harris*, 12 Wall. (U. S.) 82 (1870); *Copeland v. Memphis, etc. R. Co.*, 3 Woods (U. S.) 651 (1878); *Bishop v. Brainerd*, 28 Conn. 289 (1859).

<sup>1</sup> *United States*: In *Muller v. Dows*,

*Quincy Railroad Bridge Co. v. Adams County*,<sup>1</sup> the Supreme Court of Illinois said: "The only possible *status* of a company acting under charters from two States is that it is an association incorporated in and by each of the States, and, when acting as a corporation in either of the States, it acts under the authority of the charter of the State in which it is then acting and

94 U. S. 447 (1876), where a Missouri and an Iowa corporation had consolidated, the Supreme Court of the United States said: "The two companies became one. But in the State of Iowa it was an Iowa corporation, existing under the laws of that State alone. The laws of Missouri had no operation in Iowa."

Also *Nashua, etc. R. Corp. v. Boston, etc. R. Corp.*, 136 U. S. 381 (1890), (10 Sup. Ct. Rep. 1004); *Peik v. Chicago, etc. R. Co.*, 94 U. S. 177 (1876); *Delaware R. R. Tax Cases*, 18 Wall. (U. S.) 206 (1873); *Railroad Co. v. Whitton*, 13 Wall. (U. S.) 271 (1871); *Missouri Pacific R. Co. v. Meeh*, 69 Fed. 755 (1895), (30 L. R. A. 250); *Fitzgerald v. Missouri Pacific R. Co.*, 45 Fed. 812 (1891); *Burger v. Grand Rapids, etc. R. Co.*, 22 Fed. 561 (1884).

*Illinois*: *Ohio, etc. R. Co. v. People*, 123 Ill. 467 (1888), (14 N. E. Rep. 874); *Quincy Railroad Bridge Co. v. Adams County*, 88 Ill. 615 (1878); *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595).

*Michigan*: *Chicago, etc. R. Co. v. Auditor General*, 53 Mich. 91 (1884), (18 N. W. Rep. 586), (*per Cooley, C. J.*): "It is impossible to conceive of one joint act performed simultaneously by two sovereign States which shall bring a single corporation into being except it be by compact or treaty. There may be separate consent given for the consolidation of corporations separately created; but where the two unite, they severally bring to the new entity the powers and privileges already possessed, and

the consolidated company simply exercises in each jurisdiction the powers the company there chartered had possessed."

*Minnesota*: *In re St. Paul, etc. R. Co.*, 36 Minn. 85 (1886), (30 N. W. Rep. 432).

*Nebraska*: *Trester v. Missouri Pac. R. Co.*, 33 Neb. 171 (1891), (49 N. W. Rep. 1110).

*New York*: *People v. New York, etc. R. Co.*, 129 N. Y. 474 (1892), (29 N. E. Rep. 361, 15 L. R. A. 82); *Sage v. Lake Shore, etc. R. Co.*, 70 N. Y. 220 (1877).

*Pennsylvania*: *Appeal of Pittsburgh, etc. R. Co.*, 4 Atl. Rep. 385 (1886).

*Texas*: *Whaley v. Bankers' Union of the World* (Tex. Civ. App. 1905), 88 S. W. Rep. 259: "Corporations have no power to consolidate unless the power is expressly conferred by their charters, or by the charter of one of them, or by some other statute, and the consolidation must be effected in compliance with the terms of the statute. And when corporations are created by different States, as were those involved in this case, they can only consolidate under concurrent legislation of each State; but in such a case, since the laws of the State have no extraterritorial effect, they cannot create or aid in creating a corporation in another State; and there is, in law, a separate and distinct corporation in each State when corporations are consolidated by virtue of concurrent legislation."

<sup>1</sup>*Quincy Railroad Bridge Co. v. Adams County*, 88 Ill. 615 (1878).

that only, the legislation of the other State having no operation beyond its territorial limits." And in *Fitzgerald v. Missouri Pacific R. Co.*,<sup>1</sup> Judge Caldwell said: "By the consolidation, the corporation of one State did not become a corporation of another, nor was either merged in the other. The corporation of each State had a distinct legislative paternity, and the separate identity of each as a corporation of the State by which it was created, and as a citizen of that State, was not lost by the consolidation. Nor could the consolidated company become a corporation of three States without being a corporation of each, or of either. While the consolidated corporation is a unit, and acts as a whole in the transaction of its corporate business, it is not a corporation at large, nor is it a joint corporation of the three States. Like all corporations, it must have a legal dwelling-place. Every corporation, not created by act of Congress, dwells in a State. This consolidated corporation dwells in three States, and is a separate and single entity in each."

This principle that an interstate consolidated corporation is a separate and distinct entity in each State is clearly established, and is, perhaps, necessary in order to give each State its legitimate control over the charters which it grants. It is, however, founded, in a measure, upon a legal fiction, for it makes several corporations out of that which is, in fact, one, and ignores the essential element of *union*.<sup>2</sup>

That the consolidated corporation, itself, has an existence apart from its constituents may be recognized without affecting the principles already considered. Thus in *Ashley v. Ryan*,<sup>3</sup> the Supreme Court of Ohio said: "There has been some diversity of opinion as to the *status* of a corporation formed by the consolidation of companies under the laws of different States. But it seems pretty well settled, upon principle at least, that when formed under coöperative legislation of the different States, it becomes a corporation in each State where its road is located. It is a legal entity residing and doing business

<sup>1</sup> *Fitzgerald v. Missouri Pacific R. Co.*, 45 Fed. 615 (1891).

<sup>2</sup> *Horne v. Boston, etc. R. Co.*, 18 Fed. 50 (1883).

<sup>3</sup> *Ashley v. Ryan*, 49 Ohio St. 529 (1892), *affirmed* 153 U. S. 436 (1894), (14 Sup. Ct. Rep. 865).

in different States, with a *status* in each, derived from and determined by the laws of that State."

It has also been held that a consolidated railroad corporation, chartered and operated in two States and made subject to the laws of one State as if wholly located therein, is a single entity so far as the power of the courts of that State to fix rates is concerned.<sup>1</sup> It is also held that the acts and neglects of an interstate consolidated corporation are its acts and neglects as a whole.<sup>2</sup>

Constitutional provisions in several States define the *status* of interstate consolidated corporations.<sup>3</sup>

<sup>1</sup> *Providence Coal Co. v. Providence, etc. R. Co.*, 15 R. I. 303 (1886), (4 Atl. Rep. 394).

<sup>2</sup> *Horne v. Boston, etc. R. Co.*, 18 Fed. 50 (1883). See also *Burger v. Grand Rapids, etc. R. Co.*, 22 Fed. 561 (1884); *Fitzgerald v. Missouri Pac. R. Co.*, 45 Fed. 812 (1891).

An interstate consolidated corporation is a "new" corporation whose charter, under Mich. Const. Art. 15, § 1, is subject to amendment, alteration or repeal. *Smith v. Lake Shore, etc. R. Co.*, 114 Mich. 460 (1897), (72 N. W. Rep. 328).

<sup>3</sup> *Idaho*: Const. Art. XI. § 14: "If any railroad, telegraph, express, or other corporation, organized under any of the laws of this State, shall consolidate, by sale or otherwise, with any railroad, telegraph, express, or other corporation organized under any of the laws of any other State or Territory, or of the United States, the same shall not thereby become a foreign corporation; but the courts of this State shall retain jurisdiction over that part of the corporate property within the limits of the State in all matters that may arise, as if said consolidation had not taken place."

*Kentucky*. Const. § 200: "If any railroad, telegraph, express, or other corporation, organized under the laws of this Commonwealth, shall consolidate, by sale or otherwise, with any

railroad, telegraph, express, or other corporation organized under the laws of any other State, the same shall not thereby become a foreign corporation, but the courts of this Commonwealth shall retain jurisdiction over that part of the corporate property within the limits of this State in all matters which may arise, as if said consolidation had not taken place."

*Louisiana*. Const. Art. CCXLVI.: "If any railroad company, organized under the laws of this State, shall consolidate, by sale or otherwise, with any railroad company organized under the laws of any other State or of the United States, the same shall not thereby become a foreign corporation, but the courts of this State shall retain jurisdiction in all matters which may arise, as if said consolidation had not taken place. In no case shall any consolidation take place except upon public notice of at least sixty days to all stockholders, in such manner as may be provided by law."

*Missouri*. Const. Art. XII. § 18. Same as *Louisiana*, *supra*.

*Montana*. Const. Art. XV. § 15: "If any railroad, telegraph, telephone, express, or other corporation or company organized under any of the laws of this State shall consolidate, by sale or otherwise, with any railroad, telegraph, telephone, express, or other

§ 102. **Effect of Interstate Consolidation upon Status of Constituent Corporations.** — Upon the creation of an interstate consolidated corporation the constituent corporations of the different States do not cease to exist, although they may lie dormant and their property, rights, powers and franchises be vested in and exercised by the consolidated corporation.<sup>1</sup> In *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*<sup>2</sup> the Supreme Court of Illinois said: "Our view of the effect of the consolidation between the [corporations of different States] which we hold to have been legally made, is briefly this: While it created a community of stock and of interest between the two companies, it did not convert them into one company, in the same way, and to the same degree, that might follow a consolidation of two companies within the same State. Neither Illinois nor Wisconsin, in authorizing the consolidation, can have intended to abandon all jurisdiction over its own corporation created by itself. Indeed, neither State could take jurisdiction over the property or proceedings of the corporation beyond its own limits and a corporation can have no

corporation organized under any of the laws of any other State or Territory, or of the United States, the same shall not thereby become a foreign corporation; but the courts of this State shall retain jurisdiction over that part of the corporate property within the limits of the State, in all matters that may arise, as if said consolidation had not taken place."

<sup>1</sup> Ohio, etc. R. Co. v. People, 123 Ill. 467 (1888), (14 N. E. Rep. 874); Taggart v. Northern Central R. Co., 29 Md. 557 (1868); Bishop v. Brainerd, 28 Conn. 289 (1859). Where two corporations are created by adjacent States, with the same name, to construct a canal in each of the States and afterwards their interests are united by legislative acts of the States respectively, this does not merge the separate corporate existence of such corporations. Farnum v. Blackstone Canal Co., 1 Sumn. (U. S.) 62 (1830). In Nashua, etc.

R. Co. v. Boston, etc. R. Co., 136 U. S. 382 (1890), (10 Sup. Ct. Rep. 1004), the Supreme Court of the United States said: "It is evident that, by the general law, railroad corporations created by two or more States, though joined in their interests, in the operation of their roads, in the issue of their stock, and in the division of their profits, so as practically to be a single corporation, do not lose their identity; and that each one has its existence and its standing in the courts of the country, only by virtue of the legislation of the State by which it is created. The union of name, of officers, of business and of property, does not change their distinctive character as separate corporations."

See also Paul v. Baltimore, etc. R. Co., 44 Fed. 513 (1890).

<sup>2</sup> Racine, etc. R. Co. v. Farmers Loan, etc. Co., 49 Ill. 348 (1868), (95 Am. Dec. 595).

existence beyond the limits of the State sovereignty which brings it into life and endows it with faculties and powers.”<sup>1</sup>

§ 103. **Management of Interstate Consolidated Corporation.** — While a corporation created by the consolidation of corporations of different States is a domestic corporation of each State and derives its powers, in each State, from local laws, yet, in the conduct of its business, it acts as a unit, — as one corporation and not as several, — “and, in the absence of a statutory provision to the contrary, it may transact its corporate business in one State for all, and the contracts it enters into and the liabilities it incurs in one State are binding upon it in all the States and may be enforced against it in any one of them when the action is transitory.”<sup>2</sup>

A meeting in one of several States of the stockholders of a corporation created by the consolidation of corporations of those States is valid with respect to the property of the corporation in all of them, without the necessity of a repetition of such meeting in the other States.<sup>3</sup>

The affairs of an interstate consolidated corporation may be — and uniformly are — administered by a single board of directors which may control, manage and dispose of its property situated in the different States. In the case quoted from in the last section — *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*<sup>4</sup> — the Supreme Court of Illinois also said: “When continuous lines of road, passing through different States, are consolidated by legislative authority . . . although the consolidated company must, from the very nature of a corporation, be regarded as a distinct entity in each State, yet the objects of consolidation would be very liable to be defeated, unless the entire line should be placed under one board of

<sup>1</sup> See *Ohio, etc. R. Co. v. Wheeler*, 1 Black (U. S.) 297 (1861).

<sup>2</sup> *Fitzgerald v. Missouri Pacific R. Co.*, 45 Fed. 816 (1891), (*per Caldwell, J.*). Also *Graham v. Boston, etc. R. Co.*, 118 U. S. 169 (1886), (6 Sup. Ct. Rep. 1009); *Horne v. Railroad Co.*, 62 N. H. 454 (1883); *Providence Coal Co. v. Providence, etc. R. Co.*, 15 R. I. 303 (1886), (4 Atl. Rep. 394); *Burger v. Grand Rapids, etc. R. Co.*, 22 Fed.

561 (1884); *Horne v. Boston, etc. R. Co.* 18 Fed. 50 (1883).

<sup>3</sup> *Graham v. Boston, etc. R. Co.*, 118 U. S. 161 (1886), (6 Sup. Ct. Rep. 1009). Compare *Aspinwall v. Ohio, etc. R. Co.*, 20 Ind. 492 (1863), (83 Am. Dec. 329).

<sup>4</sup> *Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595).

directors. . . . When the consolidated lines are placed under a common board, with a common name and seal, such board will, naturally, act as if the consolidated lines made but one company, and when their contracts assume that form, the courts must, for the protection of the public, and to enforce good faith, hold, as we have done in this case, that the contract is to be construed as made by the corporation of each State in which the subject matter of the contract lies: *ut res magis valeat quam pereat*."

§ 104. **Rights and Powers of Interstate Consolidated Corporation.** — An interstate consolidated corporation may exercise all the powers and privileges conferred upon it — expressly or by reference — in the acts authorizing the consolidation and, as a general rule, stands in each State in the position of its constituent corporation in that State.<sup>1</sup>

An interstate consolidated corporation is a domestic corporation within a State and entitled to exercise the power of eminent domain granted by a State to its corporations.<sup>2</sup> It has been held, however, that an act authorizing the consolidation of a domestic railroad company with corporations of other States and granting the consolidated company "all the faculties, powers, authorities, privileges and franchises conferred upon it by any of said States," relates simply to the faculties necessary for the general objects of its business and does not affect the local law in regard to the method of obtaining title to the right of way.<sup>3</sup>

<sup>1</sup> Delaware R. R. Tax Cas., 18 Wall. (U. S.) 206 (1873).

A railroad corporation formed under a Pennsylvania statute by the consolidation of a corporation of that State with a New York corporation has all the rights and franchises of the consolidating corporations including the right of the Pennsylvania corporation to increase its capital, up to a stated amount per mile, without payment of bonus.

Commonwealth v. Buffalo, etc. R. Co., 207 Pa. 160 (1903), (56 Atl. Rep. 412).

<sup>2</sup> Trester v. Missouri Pacific R. Co.,

33 Neb. 171 (1891), (49 N. W. Rep. 1110).

The power of a railroad company to begin proceedings for the condemnation of lands within the State is not lost by its consolidation with another railroad company into a new organization, so as to constitute a corporation subject to the laws of the same State as the original company. Toledo, etc. R. Co. v. Dunlap, 47 Mich. 456 (1882), (11 N. W. Rep. 271).

<sup>3</sup> Pittsburgh, etc. R. Co. v. Reich, 101 Ill. 174 (1887): "It [the act] relates to the corporation itself, and is designed to make it a unit in each and



An interstate consolidated corporation acquires in each State, among other rights and powers, the right therein of its constituent corporation to issue bonds secured by mortgage;<sup>1</sup> and may issue them to take up bonds previously issued by such constituent.<sup>2</sup>

§ 105. **Duties of Interstate Consolidated Corporation — Taxation.** — A corporation formed by the consolidation of corporations of different States stands in relation to each State as a separate domestic corporation, governed by the laws of that State with respect to its property and franchises therein and subject to taxation in conformity with the laws, and to the exercise of the police power, of such State.<sup>3</sup> The property of each constituent corporation remains subject to taxation in the same manner as before the consolidation.<sup>4</sup> Each State,

all of the States in which its line is located, but it does not assume to affect the local law in regard to acquiring title to right of way."

<sup>1</sup> *Mead v. New York, etc. R. Co.*, 45 Conn. 221 (1877): "That these laws gave to the original New York, Housatonic and Northern Railroad Company full power and authority to mortgage its property and franchises in this State as well as in the State of New York, to secure the payment of such sum or sums of money borrowed as might be necessary for completing and finishing and operating its railroad, counsel for the plaintiffs in error admit. But they deny that the consolidated company had any such power. It has, however, been shown that the effect of the consolidation was to confer upon, and give to, the consolidated company in this State, all the rights, powers, privileges, exemptions, franchises and property possessed by the original New York, Housatonic and Northern Railroad Company in this State . . . and this, of course, included the power of borrowing money and mortgaging the property and franchises of a corporation in this State to secure its payment. The mortgage was, there-

fore, a valid security for the purposes for which it was executed, and operated as a lien upon the franchises as well as upon the real and personal property which became vested in the consolidated corporation by the agreement and act of consolidation."

See also *Racine v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595).

<sup>2</sup> *Mead v. New York, etc. R. Co.*, 45 Conn. 221 (1877).

<sup>3</sup> *Ohio, etc. R. Co. v. People*, 123 Ill. 467 (1888), (14 N. E. Rep. 874).

A corporation formed by the consolidation of various foreign and domestic railroad companies is a domestic, not a foreign corporation, and, therefore, the provisions of a *New York* statute compelling transfer agents of foreign corporations to exhibit lists of their stockholders, have no application to it. *Sage v. Lake Shore, etc. R. Co.*, 70 N. Y. 220 (1877).

<sup>4</sup> *Delaware R. R. Tax. Cas.*, 18 Wall. (U. S.) 206 (1873); *Philadelphia, etc. R. Co. v. Maryland*, 10 How. (U. S.) 377 (1850); *Ohio, etc. R. Co. v. Weber*, 96 Ill. 443 (1880); *Quincy R., etc. Co. v. Adams County*, 88 Ill. 615 (1878).

participating in the creation of an interstate consolidated corporation, may legislate for such corporation just as it would for its original companies, if no consolidation had taken place. Corporations and stockholders from other States having availed themselves of the advantages of an interstate consolidation cannot repudiate the corresponding obligations.<sup>1</sup>

An interstate consolidated corporation is "incorporated under the laws of this State" within the meaning of a statute taxing corporations so incorporated.<sup>2</sup>

A provision in an act authorizing the consolidation of corporations of different States that the new consolidated company shall be entitled to all the rights, privileges and immunities which each and all of its constituents enjoyed under their respective charters, in no respect changes the position of the consolidated company in any State, with reference to taxation, from that of the original corporation in such State.<sup>3</sup>

**§ 106. Citizenship of Interstate Consolidated Corporation.** — Upon principles already indicated, an interstate consolidated corporation is, for the purpose of determining the jurisdiction of the federal courts and for securing to the judicial tribunals of each State due control over corporations and corporate property therein, conclusively presumed to be a citizen of each State concurring in its creation. "It enjoys in each State all the powers and privileges the corporations there chartered had and must answer in the courts and is amenable to the

The Michigan general railroad law in permitting the consolidation of railroad companies within the State with others beyond its boundaries, contemplates leaving the domestic company in its original position as to stock and loans and annexing to its capital and loans (for purposes of taxation) additions which are made proportional to the original amounts. *Lake Shore, etc. R. Co. v. People*, 46 Mich. 193 (1881), (9 N. W. Rep. 249).

<sup>1</sup> *Peik v. Chicago, etc. R. Co.*, 94 U. S. 177 (1876): "Upon these terms the consolidation was finally perfected and the consolidated company now exists under the two jurisdictions, but subject to the same legislative control

as to its business in Wisconsin as private persons. The Illinois companies might have stayed out. But they chose to come in and must now abide the consequences. Thus, Wisconsin is permitted to legislate for the consolidated company in that State precisely the same as it would for its own original companies, if no consolidation had taken place."

<sup>2</sup> *Ohio, etc. R. Co. v. Weber*, 96 Ill. 443 (1880). - *Compare People v. New York, etc. R. Co.*, 129 N. Y. 474 (1892), (29 N. E. Rep. 959, 15 L. R. A. 82).

<sup>3</sup> *Delaware R. R. Tax Cas.*, 18 Wall. (U. S.) 228 (1873). See *ante*, § 72: "*Exemptions from Taxation.*"

laws of each State, respectively, as a corporation of that State."<sup>1</sup>

An interstate consolidated corporation, therefore, being a citizen of each of the States of its constituent companies, cannot, when sued in one of those States, claim the right of removal to the federal courts upon the ground that it is a citizen of another State.<sup>2</sup>

The true underlying principle seems to be that the consolidated corporation, by the concurrent legislation, is, itself, created a citizen of each State. In many decisions of unquestioned authority, however, it is reasoned that each constituent corporation retains its identity and citizenship and that it,

<sup>1</sup> *Fitzgerald v. Missouri Pacific R. Co.*, 45 Fed. 812 (1891). In *Railroad Co. v. Harris*, 12 Wall. (U. S.) 82 (1870), the Supreme Court said: "The jurisdictional effect of the existence of such a [consolidated] corporation as regards the federal courts, is the same as that of a copartnership of individual citizens residing in different States."

<sup>2</sup> *United States v. Nashua, etc. R. Corp. v. Boston, etc. R. Corp.*, 136 U. S. 382 (1890), (10 Sup. Ct. Rep. 1004); *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094), *affirming s. c. sub nom. St. Louis, etc. R. Co. v. Indianapolis, etc. R. Co.*, 9 Biss. (U. S.) 144 (1879); *Muller v. Dows*, 94 U. S. 444 (1876); *Railway Co. v. Whitton*, 13 Wall. (U. S.) 270 (1871); *Fitzgerald v. Missouri Pacific R. Co.*, 45 Fed. 812 (1891); *Paul v. Baltimore, etc. R. Co.*, 44 Fed. 513 (1890); *Central Trust Co. v. Rochester, etc. R. Co.*, 29 Fed. 609 (1886). Compare *Conn v. Chicago, etc. R. Co.*, 48 Fed. 177 (1891).

Notwithstanding the provision of a statute that a foreign railroad company desiring to do business or exercise any corporate franchise within the State, must comply with certain conditions and that upon complying therewith it shall become a domestic

corporation, the character of the original corporation is not changed and it does not become a citizen of the State so far as to affect the jurisdiction of the federal courts based upon diverse citizenship.

*Southern R. Co. v. Allison*, 190 U. S. 326 (1902), (23 Sup. Ct. Rep. 713).

A corporation simultaneously and voluntarily organized in several States exists in each State by virtue of the laws thereof, and when it incurs liability in any such State and is sued therein it cannot remove the case to the federal court upon the ground that it is also incorporated in another State. *Southern R. Co. v. Allison*, *supra*, distinguished upon the ground that in that case the corporation was *compelled* to become a corporation of another State.

*Patch v. Wabash R. Co.*, 207 U. S. 277 (1907), (28 Sup. Ct. Rep. 80).

The last two cases, although not dealing with consolidated corporations as such, should be examined as being the latest decisions of the Supreme Court upon the general subject.

*Georgia: Angier v. East Tennessee, etc. R. Co.*, 74 Ga. 634 (1885).

*Illinois: Racine, etc. R. Co. v. Farmers Loan, etc. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595).

in reality, is the corporation sued.<sup>1</sup> The distinction is that between an association of different citizens and one person possessing different attributes of citizenship.

An interstate consolidated corporation, upon similar principles, may institute a suit in a federal court as a citizen of a State concurring in its creation.<sup>2</sup> Upon principle it would seem, however, that it could not maintain such a suit in a State also concurring in its creation.

*Michigan*: Chicago, etc. R. Co. v. Auditor General, 53 Mich. 92 (1884), (18 N. W. Rep. 586).

*New Hampshire*: Horne v. Boston, etc. R. Co., 62 N. H. 454 (1883).

<sup>1</sup> Nashua, etc. R. Corp. v. Boston, etc. R. Corp., 136 U. S. 356 (1890), (10 Sup. Ct. Rep. 1004); Pennsylvania R. Co. v. St. Louis, etc. R. Co., 118 U. S. 297 (1886), (6 Sup. Ct. Rep. 1094); *s. c. sub nom.* St. Louis, etc. R. Co. v. Indianapolis, etc. R. Co., 9 Biss. (U. S.) 144 (1879).

Notwithstanding the consolidation of two railroad corporations of different States, each retains its identity as a corporation of the State in which it was originally created; and in a suit against the consolidated corporation brought in one of such States it cannot obtain a removal to the federal courts on the ground that it is a citizen of the other State, though the consolidation was had under the laws of the latter State. Paul v. Baltimore, etc. R. Co., 44 Fed. 514 (1890).

Under a statute authorizing the consolidation of a railroad company of the State or with a foreign railroad company when domesticated within the State and, upon consolidation, the issuance of a charter to the consolidated company, it has been held that where the consolidation takes the form of an absorption by the foreign company of all the property and franchises of the domestic corporation, the former does not by obtaining a charter of consolidation

become a citizen of the State with respect to the jurisdiction of the federal courts but remains a citizen of the State of its creation, although by obtaining the charter it becomes a domestic corporation for other purposes.

Lee v. Atlantic Coast Line R. Co., 150 Fed. 775 (1906).

<sup>2</sup> In St. Louis, etc. R. Co. v. Indianapolis, etc. R. Co., 9 Biss. (U. S.) 144 (1879), (*affirmed sub nom.* Pennsylvania R. Co. v. St. Louis, etc. R. Co., 118 U. S. 297 (1886), (6 Sup. Ct. Rep. 1094), Judge Drummond said: "If the defendant corporation, though consolidated with another of a different State, can be sued in the federal court in the State of its creation as a citizen thereof, why can it not sue as a citizen of the State which created it? I can see no difference in the principle. It seems to me that when the plaintiff comes into the federal court, if a corporation of another State, it is clothed with all the attributes of citizenship which the laws of that State confer, and the shareholders of that corporation must be conclusively regarded as citizens of the State which created the corporation precisely the same as if it were a defendant." Quoted with approval by Mr. Justice Field in Nashua, etc. R. Corp. v. Boston, etc. R. Corp., 136 U. S. 378 (1890), (10 Sup. Ct. Rep. 1004). The conclusion was reached in this case that one consolidating corporation, as a citizen of one State, might sue another consolidating cor-

§ 107. **Foreclosure of Mortgages after Interstate Consolidation. Jurisdiction.** — A State is not presumed to waive its jurisdiction. Such waiver must be clearly expressed. Upon these principles it has been held that an action cannot be maintained in one State to foreclose a mortgage, existing at the time of the consolidation, upon property of a constituent corporation situated in another State, which has never granted permission to maintain such action.<sup>1</sup>

A court of equity of one State, however, acting *in personam*, may entertain jurisdiction of a suit to foreclose a mortgage executed by an interstate consolidated corporation covering as an entirety property situated in several States; and may require the defendant to convey to a receiver the property outside its jurisdiction.<sup>2</sup> In *Muller v. Dows*,<sup>3</sup> Mr. Justice Strong said: "A vast number of railroads partly in one State and partly in an adjoining State, forming continuous lines, have been constructed by consolidated companies, and mortgaged as entireties. It would be safe to say that more than one hundred millions of dollars have been invested on the faith of such mortgages. In many cases these investments are sufficiently insecure at the best. But if the railroad, under legal process, can be sold only in fragments; if, as in this case, where the mortgage is upon the whole line, and includes the franchises of the corporation which made the mortgage, the decree of foreclosure and sale can reach only the part of the road which is within the State, — it is plain that the property must be comparatively worthless at the sale. A part of a railroad may be of little value when its ownership is severed from the ownership of another part. And the franchise of the company is not capable of division. In view of this, before we can set aside the decree which was made it ought to be made clearly to appear beyond the power of the court. With-

poration in a federal court, as a citizen of another State. Manifestly, however, an interstate consolidated corporation — as an *entity* — cannot sue itself, although it possesses different attributes in different States.

<sup>1</sup> *Eaton, etc. R. Co. v. Hunt*, 20 Ind. 464 (1863); *Pittsburgh, etc. R.*

*Co. v. Rothschild*, 4 Cent. Rep. 107 (1886).

<sup>2</sup> *Muller v. Dows*, 94 U. S. 449 (1876); *Mead v. New York, etc. R. Co.*, 45 Conn. 199 (1877).

<sup>3</sup> *Muller v. Dows*, 94 U. S. 449 (1876).

out reference to the English chancery decisions, where this objection to the decree would be quite untenable, we think the power of courts of chancery in this country is sufficient to authorize such a decree as was here made. It is here undoubtedly a recognized doctrine that a court of equity sitting in a State and having jurisdiction of the person, may decree a conveyance by him of land in another State, and may enforce the decree by process against the defendant."

## PART II

### CORPORATE SALES

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#### ARTICLE I

### SALES OF CORPORATE PROPERTY AND FRANCHISES

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#### CHAPTER XI

##### SALES OF CORPORATE PROPERTY

###### *I. Sales of Property of Private Corporations*

- § 108. Power to purchase and sell generally.
- § 109. Sale of Entire Corporate Property by Unanimous Consent.
- § 110. Sale of Entire Property of Prosperous Corporation by Majority Vote.
- § 111. Sale of Entire Property of Losing Corporation by Majority Vote.
- § 112. Sale of Entire Corporate Property by Directors.
- § 113. Ratification by Stockholders of Sale by Directors.
- § 114. Remedies of Dissenting Stockholders in Case of Invalid or Unfair Sales. Voidable Sales.
- § 115. Procedure in Stockholders' Actions.
- § 116. Defences to Stockholders' Actions. Estoppel. Laches.
- § 117. Effect of Sale of Entire Corporate Property.

###### *II. Exchange of Property of One Corporation for Stock of Another*

- § 118. Transfer of Entire Corporate Property without Unanimous Consent requires Monetary Consideration.
- § 119. Exchange of Property for Stock *ultra vires*.
- § 120. Exchange of Property for Stock Infringement of Rights of Dissenting Stockholders.
- § 121. Appraisal of Stock of Dissenting Stockholders.
- § 122. Stock received upon Exchange belongs primarily to Corporation.
- § 122 a. Effect of Execution of *ultra vires* Contract for Exchange of Property for Stock.
- § 122 b. Remedies of Dissenting Stockholders in Case of Exchange of Property for Stock.

III. *Rights and Remedies of Creditors*

- § 123. Liability of Purchasing Corporation for Debts of Vendor Company.
- § 124. Fraudulent Sales.
- § 125. Remedies of Creditors.
- § 126. Priority of Purchaser's Mortgage over Claims of Vendor's Creditors.

IV. *Sales of Property of Quasi-public Corporations*

- § 127. Indispensable Property cannot be alienated or taken on Execution without Statutory Authority.
- § 128. Test of Indispensability.
- § 129. Sales of Surplus Property.
- § 129a. *Ultra vires* Sales of Property of Private and Quasi-public Corporations.

I. *Sales of Property of Private Corporations*

§ 108. **Power to purchase and sell generally.** It is an elementary principle of corporation law that a corporation, subject to the limitations of its charter and constitutional and statutory prohibitions, has inherent power to acquire and hold any property, real or personal, reasonably useful or convenient in carrying on the business for which it was organized.<sup>1</sup>

The right to acquire property carries with it the corresponding power of disposition, subject likewise to any restrictions in the charter of the corporation and considerations of

<sup>1</sup> *Lathrop v. Commercial Bank*, 8 Dana (Ky.) 114 (1839), (33 Am. Dec. 481): "No doctrine of the common law is more clearly and undeniably established than that which concedes to corporations an inherent or resulting right to acquire and hold title to land by contract, except so far only as they may be restricted by the objects of their creation, or the limitations of their charters."

See also:

*United States*: *Blanchard Gun Stock, etc. Factory v. Warner*, 1 Blatch. 277 (1848), (Fed. Cas. No. 1521).

*Illinois*: "If a corporation has power to hold real estate for any purpose, a deed to it passes the title of the grantor, and whether it has exceeded its powers in accepting the

conveyance is a question which can only be raised by the State." *Springer v. Chicago Real Estate, etc. Co.*, 102 Ill. App. 294 (1902).

*Massachusetts*: *Old Colony R. Co. v. Evans*, 6 Gray, 38 (1856).

*Michigan*: *Thompson v. Waters*, 25 Mich. 227 (1872), (12 Am. Rep. 243).

*New Jersey*: *Freeman v. Sea View Hotel Co.*, 57 N. J. Eq. 68 (1898).

*New York*: *Nicoll v. New York, etc. R. Co.*, 12 N. Y. 121 (1854); *Moss v. Averell*, 10 N. Y. 449 (1853); *Spear v. Crawford*, 14 Wend. 23 (1835), (28 Am. Dec. 513).

*North Carolina*: *Mallett v. Simpson*, 94 N. C. 37 (1886), (55 Am. Rep. 594).

*Vermont*: *Page v. Heineberg*, 40 Vt. 81 (1868), (94 Am. Dec. 378).



public policy.<sup>1</sup> As said by Mr. Justice Campbell, in *White Water, etc. Co. v. Valette*:<sup>2</sup> "It is well settled that a corporation, without special authority, may dispose of lands, goods and chattels, or any interest in the same." A private corporation, therefore, by proper corporate action—generally by its directors and always by vote of a majority of its stockholders—may sell any portion of its property not sufficient to constitute an abandonment of its business.<sup>3</sup>

**§ 109. Sale of Entire Corporate Property by Unanimous Consent.**—A corporation which, in consideration of the grant of franchises, has assumed the performance of public duties—a *quasi-public* corporation—cannot dispose of all its prop-

<sup>1</sup> *United States*: *Jones v. Guaranty, etc. Co.*, 101 U. S. 625 (1879): "At the common law, every corporation had, as incident to its existence, the power to acquire, hold, and convey real estate, except so far as it was restrained by its charter or by act of Parliament. This comprehensive capacity included also personal effects of every kind." Also *White Water, etc. Co. v. Valette*, 21 How. 424 (1858).

A corporation, while solvent and a going concern, has the same dominion over its property as an individual and may dispose of it as it deems best, subject to the provisions of its charter and those other restraints upon conveyances which apply alike to corporations and individuals. *New Hampshire Sav. Bank v. Richey*, 121 Fed. 956 (1903).

*Alabama*: *Hall v. Tanner, etc. Engine Co.*, 91 Ala. 363 (1890), (8 So. Rep. 348).

*California*: *Miner's Ditch Co. v. Zellerbach*, 37 Cal. 543 (1869), (99 Am. Dec. 300); *People v. California College*, 38 Cal. 166 (1869).

*Georgia*: Railroad companies under the code of this State may purchase and operate steamboats in connection with their lines of road.

*Graham v. Macon, etc. R. Co.*, 120 Ga. 757 (1904), (49 S. E. Rep. 75).

*Iowa*: *Buell v. Buckingham*, 16 Iowa, 284 (1864), (85 Am. Dec. 516).

*Maryland*: *Binney's Case*, 2 Bland. 142 (1840).

*Michigan*: *Joy v. Jackson, etc. Plank Road Co.*, 11 Mich. 165 (1863).

*New Hampshire*: *Pierce v. Emery*, 32 N. H. 484 (1856).

*New York*: *Barry v. Merchants Exch. Co.*, 1 Sandf. Ch. 280 (1844).

*North Carolina*: *Benbow v. Cook*, 115 N. C. 324 (1894), (20 S. E. Rep. 453, 44 Am. St. Rep. 454).

*Ohio*: *Reynolds v. Stark County Comm'rs*, 5 Ohio, 204 (1831).

*Pennsylvania*: *Ardesco Oil Co. v. North American Oil, etc. Co.*, 66 Pa. St. 382 (1870); *Dana v. Bank of United States*, 5 W. & G. 243 (1843).

*Utah*: *Hearst v. Putnam Min. Co.*, 28 Utah, 184 (1904), (77 Pac. Rep. 753).

*England*: *Mayor, etc. of Colchester v. Lawton*, 1 V. & B. 244 (1813).

<sup>2</sup> *White Water, etc. Co. v. Valette*, 21 How. (U. S.) 424 (1858).

<sup>3</sup> In the absence of statutory prohibition, a corporation may purchase, hold and convey real estate as fully in a foreign State as in the State where it is chartered.

*Blodgett v. Lanyon Zinc Co.*, 120 Fed. 893 (1903).

erty and disable itself from fulfilling its obligations without the consent of the State—the other party to the contract. It is immaterial that all the stockholders approve of the sale.

A private corporation on the other hand, with the unanimous consent of its stockholders, may sell and dispose of its entire property without other restriction or qualification than that the purpose must be lawful and free from fraud—actual or constructive.<sup>1</sup> It may make such terms as it may deem expedient, and, if *intra vires*, may accept stock in other corporations in payment for property sold.<sup>2</sup>

But a corporation by the sale of all its property, even with the consent of all its stockholders, and by the winding up of its

<sup>1</sup> Holmes, etc. *Mfg. Co. v. Holmes*, etc. *Metal Co.*, 127 N. Y. 252 (1891), (27 N. E. Rep. 841, 24 Am. St. Rep. 448), (*per* Haight, J.): "The plaintiff was a private manufacturing corporation. It exercises no power of a public nature and has attempted no combination by which the public may in any manner be prejudiced. There are consequently no questions of public policy to be considered. . . The plaintiff had the right, with the consent of its stockholders, to sell its plant and retire from business; and it appears from the evidence in this case that the consent of all the stockholders was given to the sale that was made."

*Leathers v. Janney*, 41 La. Ann. 1123 (1889), (6 So. Rep. 884, 6 L. R. A. 661): [It is maintained] "that the sale was the whole property of the selling corporation and was, therefore, *ultra vires* and void. The inference does not follow from the predicate. There is no law prohibiting a corporation from selling all or any of its property provided its charter contains no restraint thereof and it acts under proper authority."

A private corporation—a mercantile company—owing no public duties has the same dominion as an individual over its property, and may, with the consent of all its stockholders,

discontinue business and dispose of its entire assets with a view of winding up its affairs and paying its debts. And it may for such purpose accept real estate in part payment for its stock of merchandise.

*Morisette v. Howard*, 62 Kan. 463 (1901), (63 Pac. Rep. 756).

See also *Jordan v. Collins*, 107 Ala. 572 (1894), (18 So. Rep. 137); *State v. Western Irrigating Canal Co.*, 40 Kan. 96 (1888), (19 Pac. Rep. 349, 10 Am. St. Rep. 166).

When all the stockholders have authorized a conveyance of the entire assets of a corporation any modification of such conveyance requires similar action.

*Pinchback v. Mining Co.*, 137 N. C. 171 (1904), (49 S. E. Rep. 106).

<sup>2</sup> *Kohl v. Lilienthal*, 81 Cal. 378 (1889), (20 Pac. Rep. 401, 6 L. R. A. 520). See also *post*, §§ 118–122.

A corporation has the same right as an individual to sell its property upon credit. Consequently when a corporation sells all its property to another corporation and receives in payment therefor mortgage bonds upon the property conveyed, the sale is not without consideration and, if free from fraud, is valid.

*Fort Payne Bank v. Alabama Sanitarium*, 103 Ala. 358 (1893), (15 So. Rep. 618).

affairs cannot clothe another corporation with the right to maintain its corporate life or exercise its corporate powers.<sup>1</sup>

§ 110. **Sale of Entire Property of Prosperous Corporation by Majority Vote.** — The implied contract — the contract of association — between stockholders in forming a corporation is that a majority shall bind the whole body as to all transactions within the scope of the corporate powers. The authority carries with it a corresponding obligation. The powers of a corporation must be exercised in furtherance of the objects for which it was created and with due regard to the rights of minority stockholders.<sup>2</sup>

A majority of the stockholders of a prosperous corporation have no authority to sell its entire property in order to engage in a new enterprise; for purposes of speculation, or when no reasons of expediency require the sale.<sup>3</sup> But when, in the

<sup>1</sup> *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721 (1904).

<sup>2</sup> *Ervin v. Oregon R., etc. Co.*, 27 Fed. 631 (1886), (Wallace, J.): "It cannot be denied that minority stockholders are bound hand and foot to the majority in all matters of legitimate administration of the corporate affairs; and the courts are powerless to redress many forms of oppression practised upon the minority under the guise of legal sanction which fall short of actual fraud. This is a consequence of the implied contract of association, by which it is agreed in advance that a majority shall bind the whole body as to all matters within the scope of the corporate powers. But it is also of the essence of the contract that the corporate powers shall only be exercised to accomplish the objects for which they were called into existence, and that the majority shall not control those powers to prevent or destroy the original purposes of the corporators."

*Taylor v. Chichester, etc. R. Co.*, L. R. 2 Exch. 379 (1867), (Blackburn, J.): "As the shareholders are, in substance, partners in a trading corporation, the management of

which is intrusted to the body corporate, a trust is, by implication, created in favor of the shareholders that the corporation will manage the corporate affairs, and apply the corporate funds, for the purpose of carrying out the original speculation."

<sup>3</sup> *Forrester v. Boston, etc. Min. Co.*, 21 Mont. 544, 553 (1898), (55 Pac. Rep. 229, 353): "At common law, neither the directors nor a majority of the stockholders have power to sell or otherwise transfer all the property of a going, prosperous corporation, able to achieve the objects of its creation, as against the dissent of a single stockholder. This doctrine is firmly established by the authority of adjudged cases, and rests upon the soundest principles."

*Price v. Holcomb*, 89 Iowa, 135 (1893), (56 N. W. Rep. 407): "It is unquestionably true that a private corporation holds its property as a trust fund for the stockholders and that, when a majority of the stockholders act together, they are in a sense the corporation and must act with due regard to the right of the minority. If the majority decide

opinion of a majority, the interests of the stockholders as a whole require that the affairs of a corporation should be wound up, a majority may authorize the sale of the entire assets of a corporation, for a pecuniary consideration, as a *step towards liquidation*.<sup>1</sup>

arbitrarily, and without just cause, to sell the property of the corporation to the prejudice of the minority, and thereby compel the winding up of the business of the corporation, it is a fraud upon the minority and courts of equity will interfere. If, however, just cause exists for selling the property, as when the corporation is insolvent, and the sale is necessary to pay debts, or when, from any cause, the business is a failure and an unprofitable one, and the best interests of all require it, the majority have clearly power to order the sale, and in such case their acts are not *ultra vires*." The conclusion reached in this case that the courts may determine whether "just cause" exists for winding up the affairs of a corporation is opposed to sound principle. They may properly determine whether fraud or oppression towards the minority exists, but the inquiry cannot go further without encroaching upon the rights of the majority.

The decision in *Price v. Holcomb*, *supra*, should be compared with that of the same court in the later case of *Traer v. Prospecting Co.* 124 Iowa 107 (1904), (99 N. W. Rep. 290).

The rule that a majority cannot sell the entire corporate assets has been stated very broadly by courts of high authority. Thus in *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 351 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304), the Supreme Court of Errors of Connecticut said: "It results that neither the directors nor a majority of the stockholders can sell the corporate property against the dissent of any stockholder. This

is entirely clear in case of a solvent corporation." And in *People v. Ballard*, 134 N. Y. 294 (1892), (32 N. E. Rep. 84, 17 L. R. A. 737), the New York Court of Appeals said: "While a corporation may sell its property to pay its debts or to carry on its business, it cannot sell its property in order to deprive itself of existence."

An examination of these cases, however, clearly indicates that the courts merely intended to state the general rule that a majority cannot sell the entire corporate assets of a solvent corporation and did not intend to negative the exception stated in the text that, for the *bona fide* purpose of winding up the affairs of the corporation, such power exists. In the New York cases the sales were to foreign corporations for the purpose of escaping State control over domestic companies.

<sup>1</sup> *United States*: *Hayden v. Official Red Book and Directory Co.*, 42 Fed. 876 (1890): "The right of the majority stockholders of a corporation established for manufacturing or trading purposes to wind up its affairs, and dispose of its assets, even against the objections of the minority stockholders, whenever it appears that the business can be no longer advantageously carried on, is well recognized."

*Alabama*: *Elyton Land Co. v. Dowdell*, 113 Ala. 186 (1896), (20 So. Rep. 981, 59 Am. St. Rep. 105) *semble*.

*Louisiana*: *Pringle v. Eltringham Construction Co.*, 49 La. Ann. 303 (1897), (21 So. Rep. 515).

*Maine*: *Inhabitants of Waldo-*

In *Pringle v. Eltringham Construction Co.*<sup>1</sup> Judge McEnery said: "It is a fundamental principle that, in a corporation organized for the exclusive benefit of the corporators or shareholders, the majority of its members may, in their discretion, wind up its business whenever they deem this step to be in the interests of the whole association. The majority may, without the consent of the minority, sell the whole of the company's property, close up its business and distribute its assets, provided this is done in good faith and not for the purpose of speculation and the intention of starting the company's business anew at a subsequent time."

The power to sell the entire corporate assets follows, therefore, as an incident to the power to wind up the affairs of the

borough v. Knox, etc. R. Co., 84 Me. 469 (1892), (24 Atl. Rep. 942).

*Massachusetts*: In *Treadwell v. Salisbury Mfg. Co.*, 7 Gray, 404 (1856), (66 Am. Dec. 490), Judge Bigelow said: "At common law, the right of corporations, acting by a majority of their stockholders, to sell their property is absolute, and is not limited as to objects, circumstances or quantity. . . . To this general rule there are many exceptions, arising from the nature of particular corporations, the purposes for which they were created, and the duties and liabilities imposed on them by their charters. Corporations established for objects *quasi*-public, such as railway, canal and turnpike corporations, to which the right of eminent domain and other large privileges are granted in order to enable them to accommodate the public, may fall within the exception; as also charitable and religious bodies, in the administration of whose affairs the community or some portion of it has an interest to see that their corporate duties are properly discharged. Such corporations may, perhaps, be restrained from alienating their property, and compelled to appropriate it to specific uses, by

mandamus or other proper process. But it is not so with corporations of a private character, established solely for trading and manufacturing purposes. Neither the public nor the legislature have any direct interest in their business or its management. These were committed solely to the stockholders, who have a pecuniary stake in the proper conduct of their affairs. By accepting a charter, they do not undertake to carry on the business for which they are incorporated, indefinitely, and without any regard to the condition of their corporate property. Public policy does not require them to go on at a loss. On the contrary, it would seem very clearly for the public welfare, as well as for the interest of the stockholders, that they should cease to transact business as soon as, in the exercise of a sound judgment, it is found that it cannot be prudently continued."

*Rhode Island*: *Peabody v. Westerly Water Works*, 20 R. I. 176 (1897), (37 Atl. Rep. 807).

<sup>1</sup> *Pringle v. Eltringham Construction Co.*, 49 La. Ann. 303 (1897), (21 So. Rep. 515), citing 1 Morawetz on Priv. Corp. § 413.

corporation. Corporate action towards dissolution is essentially within the powers of a corporation and, consequently, may be exercised by a majority of the stockholders.<sup>1</sup>

It has been urged that the power of a majority to wind up a corporation, and to dispose of its assets for such purpose, exists only in the case of failing concerns.<sup>2</sup> The distinction is not well drawn. Where no time is fixed for its duration in the charter of a corporation or in some general or special law,<sup>3</sup> there is no contract between the stockholders that it shall go on forever or until it becomes embarrassed. The very best time to wind up the affairs of a corporation may be — in view of future uncertainties — when it is most prosperous and has accumulated a large surplus. The determination of the question when this action shall be taken, must rest in the discretion of the majority. If unanimous consent were necessary a single stockholder might prevent action and thus, negatively, control the corporation.

The courts cannot pass upon the question whether a corporation should be wound up, further than to determine whether

<sup>1</sup> *United States*: *Hayden v. Official Red Book, etc. Co.*, 42 Fed. 876 (1890). Compare *Ervin v. Oregon R., etc. Co.*, 27 Fed. 625 (1886).

*Alabama*: *Merchants, etc. Line v. Waganer*, 71 Ala. 581 (1882).

*Louisiana*: *Pringle v. Eltringham, etc. Co.*, 49 La. Ann. 301 (1897), (21 So. Rep. 515); *Trisconi v. Winship*, 43 La. Ann. 45 (1891), (9 So. Rep. 29, 26 Am. St. Rep. 175).

*Massachusetts*: *Treadwell v. Salisbury Mfg. Co.*, 7 Gray, 393 (1856), (66 Am. Dec. 490).

*New Jersey*: *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 415 (1871).

*Pennsylvania*: *McCurdy v. Myers*, 44 Pa. St. 535 (1863); *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42 (1858), (72 Am. Dec. 685).

*Rhode Island*: *Wilson v. Central Bridge Co.*, 9 R. I. 590 (1870). Compare, however, *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881).

<sup>2</sup> *Kean v. Johnson*, 9 N. J. Eq. 401 (1853), *dictum* of Parker, Master. See also *Price v. Holcomb*, 89 Iowa, 135 (1893), (56 N. W. Rep. 407), 2 Cook on Corp. § 670.

<sup>3</sup> When the term of existence of a corporation is of fixed duration, the implied contract of the stockholders refers to such period, and the dissolution of a prosperous corporation before its expiration would require unanimous action. *Barton v. Enterprise, etc. Ass'n*, 114 Ind. 226 (1887), (16 N. E. Rep. 486, 5 Am. St. Rep. 608). Compare *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 130 (1871); *Zabriskie v. Hackensack, etc. R. Co.*, 18 N. J. Eq. 178 (1867), (90 Am. Dec. 617); *Kean v. Johnson*, 9 N. J. Eq., 401 (1853).

Where a corporation, even with such a charter, is in a failing condition, however, the majority are justified in acting *ex necessitate*.

the majority act in good faith and without oppression towards the minority. Questions of expediency in corporate management cannot properly be brought before the courts for review.<sup>1</sup>

Where the charter of a corporation, or the statutes under which it is organized, prescribe the vote of a majority of the stockholders as the proper corporate action for the sale of its property and discontinuance of its business, the majority have the absolute right to execute the power conferred.<sup>2</sup> But in such a case the power is express, rather than incidental, and must be strictly followed. Authority to make a sale of corporate assets will not justify an exchange thereof for stock in another corporation.<sup>3</sup>

<sup>1</sup> Compare, however, *Price v. Holcomb*, 89 Iowa, 135 (1893), (56 N. W. Rep. 407).

<sup>2</sup> *Metcalf v. American School Furniture Co.*, 122 Fed. 119 (1903): "The trend of the decisions is to the effect that where the charter and by-laws of a corporation, and the statute under which it was created, vest in the stockholders a right of sale of the corporate properties and discontinuance of corporate existence, such power may be exercised by them pursuant to the laws of the State to which the corporation owes life. . . The general rule under the common law undoubtedly prohibited a prosperous corporation from dissolving unless all the stockholders assented. A dissenting stockholder was enabled to prevent such a sale. . . . Where, however, the statute of the State under which the corporation was organized prescribes the manner in which a corporation may be dissolved, a minority stockholder must abide by the statutory provision and the corporate by-laws. Theoretically the law appears to be founded upon the contract between the corporation and its stockholders. A shareholder presumptively knows the power and authority conferred upon directors

and majority stockholders. When such majority undertake to exercise their legal powers, a minority stockholder cannot be heard to complain, in the absence of fraud or attempts to exceed their legal authority."

See also *Werle v. Northwestern Flint, etc. Co.* 125 Wis. 534 (1905), (104 N. W. 743); *Pitcher v. Lone Pine, etc. Min. Co.*, 39 Wash. 608 (1905), (81 Pac. Rep. 1047).

<sup>3</sup> In *Forrester v. Boston, etc. Mining Co.*, 21 Mont. 544 (1898), (55 Pac. Rep. 229, 353) it was held that a statute authorizing the holders of a majority of the shares of a mining corporation to abandon its business, sell its assets and, by amending its charter, embark in a new enterprise did not authorize the exchange of the property of a corporation for stock in a foreign corporation.

In *Traer v. Lucas Prospecting Co.*, 124 Iowa 107 (1904), (99. N. W. Rep. 290), however, it was held that where the charter of a corporation authorized it to sell all its property, and also to deal in the stock of other corporations, it had the right to sell all its property for stock in another corporation. The Court said: "The controlling purpose of the corporation, as thus expressed, was not to

A sale of the property of a prosperous corporation pursuant to the unauthorized action of a majority of the stockholders is voidable and not void. As will be shown, it may be enjoined or set aside at the suit of a minority stockholder but, in the absence of such action, it will stand.<sup>1</sup>

§ 111. **Sale of Entire Property of Losing Corporation by Majority Vote.** — The general rule that a majority cannot sell the entire assets of a prosperous corporation is based upon the principle that a majority cannot control corporate powers to defeat corporate purposes. It is subject to the exception — noted in the last section — that such sale may be made as a step towards dissolution.

The power of a majority to dispose of all the property of a conduct mining operations itself, but to secure mineral or supposed mineral lands, and to prospect them. The power to sell and convey any rights thus acquired is expressly given. . . The express power here given, construed in connection with the declared object and business of the corporation, and the general power to sell given by the terms of article 2 clearly conferred the power to sell all of the property of the corporation notwithstanding the dissent of any individual stockholder. . . . It is, undoubtedly, the general rule that a corporation may not sell any part or all of its property for other than a cash consideration, unless authorized to do so by its charter. . . . But the articles of incorporation expressly gave the Lucas company the right to purchase, sell and deal in the corporate stocks of corporations authorized to conduct mining operations. It had mining rights and property to sell, but no power to mine; hence, we think the power to exchange or sell its properties for the stock of a corporation which would engage in the business is implied."

See also *post*, § 120: "*Exchange of Property for Stock Infringement of Rights of Dissenting Stockholders.*"

<sup>1</sup> In *Tanner v. Lindell R. Co.*, 180 Mo. 17 (1904), (79 S. W. Rep. 155) the Court said: "None of the authorities cited says that a sale of all the property of a corporation pursuant to a resolution of a majority of its members is void. They all recognize that the majority in interest have the right to rule within reasonable bounds and that whilst they have no right, arbitrarily or oppressively, to close out a corporation for their own advantage yet they are not compelled to continue an unprofitable business or to pay the minority more than their stock is worth for the privilege of closing it up. The principle invoked by the plaintiffs is wise and just, but, since it is liable to abuse, its wisdom and justice are seen only in its application to the facts of the given case. It is, as before said, designed for the protection of the minority, but like some other equitable principles it is to be used as a shield, not as a sword."

See also *Boston, etc. Min. Co. v. Montana Ore-Purchasing Co.*, 89 Fed. 529 (1903).

*Compare*, however, *Forrester v. Boston, etc. Min. Co.*, 29 Mont. 397 (1903), (76 Pac. Rep. 211).



losing corporation, however, is in furtherance of the purposes of the corporation and arises *ex necessitate*.

When the further prosecution of the business of the corporation would be unprofitable, it is the duty, as well as the right, of the majority to dispose of its property and take action towards the liquidation of its affairs.<sup>1</sup>

§ 112. **Sale of Entire Corporate Property by Directors.** — The directors of a corporation are appointed to manage its affairs. They have implied authority to acquire and dispose of its property in the usual course of business. They have no right to take any action which will thwart the purpose for which the corporation was created.

The powers of directors are defined by the charter and by-laws of the corporation. The extraordinary power of disposing of the entire corporate assets *might* be conferred upon

<sup>1</sup> *United States*: *Hayden v. Official Hotel Red Book, etc. Co.*, 42 Fed. 875 (1890); *Hancock v. Holbrook*, 9 Fed. 353 (1881). *Compare* *Hunt v. American Grocery Co.*, 81 Fed. 532 (1897).

*Iowa*: *Price v. Holcomb*, 89 Iowa, 123 (1893), (56 N. W. Rep. 407). *Compare* *Buell v. Buckingham*, 16 Iowa, 284 (1864), (85 Am. Dec. 516).

*Louisiana*: *Hancock v. Holbrook*, 40 La. Ann. 53 (1883), (3 So. Rep. 351).

*Massachusetts*: *Treadwell v. Salisbury Mfg. Co.*, 7 Gray, 393, 404 (1856), (66 Am. Dec. 490); *Sargent v. Webster*, 13 Met. 497 (1847), (46 Am. Dec. 743).

*Michigan*: *Doyle v. Leitelt*, (Mich. 1893), 56 N. W. Rep. 553.

*Minnesota*: *Rothwell v. Robinson*, 44 Minn. 538 (1890), (47 N. W. Rep. 255).

*Mississippi*: *Berry v. Broach*, 65 Miss. 453 (1888), (4 So. Rep. 117).

*New Jersey*: *Sewell v. East Cape May Beach Co.*, 50 N. J. Eq. 717 (1892), (25 Atl. Rep. 929).

*New York*: *Skinner v. Smith*, 134 N. Y. 240 (1892), (31 N. E. Rep. 911).

*Quaere* *People v. Ballard*, 136 N. Y. 639 (1892), (32 N. E. Rep. 611, 17 L. R. A. 737), motion for reargument of s. c. 134 N. Y. 269 (1892), (32 N. E. Rep. 54).

*Rhode Island*: *Phillips v. Providence Steam Engine Co.*, 21 R. I. 304 (1899), (43 Atl. Rep. 598, 45 L. R. A. 560): "There is a difference of opinion as to the power of a corporation to sell its entire property and thus practically retire from business. Some courts hold that it may be done by the consent of all the stockholders and others that it may be done by a majority. . . . We think this the correct rule [that majority may authorize sale when the corporation is no longer able to profitably continue its business.] It has been recognized in this State. . . . The principle upon which these cases rests is that a corporation may dispose of its property by a majority vote in cases which are free from unfairness, oppression and fraud. Against wrongs of this kind equity will interfere."

*Wisconsin*: *Werle v. Northwestern Flint, etc. Co.*, 125 Wis. 534 (1905), (104 N. W. Rep. 743).

them.<sup>1</sup> But, unless expressly conferred, the directors of a prosperous corporation have no power to sell out its entire property and deprive it of the means of continuing business. And the directors of a losing, but not insolvent, corporation are equally without implied authority to wind up its affairs and dispose of its assets.<sup>2</sup>

The distinction between a losing corporation able to pay its debts and an insolvent corporation must be observed. The transfer of the entire property of the one involves primarily the relations between a corporation and its stockholders; of

<sup>1</sup> *Mahaska County R. Co. v. Des Moines Valley R. Co.*, 28 Iowa, 451 (1870).

<sup>2</sup> In the leading case of *Abbott v. American Hard Rubber Co.*, 33 Barb. (N. Y.) 578 (1861), a majority of the trustees of a business corporation transferred all its personal property, which was especially adapted to its business, to two persons, who forthwith caused another corporation to be formed, and transferred such property to it. It was held, that as such transfer practically terminated the corporation by taking from it the power to fulfil the object of its organization, it was a violation of that object, was not within the power of the trustees, and was *ultra vires* and void.

*Compare Wolf v. Arminius Copper Mine Co.*, 6 Misc. (N. Y.) 562 (27 N. Y. Supp. 642) (1894), distinguishing *Abbott v. American Hard Rubber Co.*, *supra*.

For other cases holding that the directors of a corporation have no implied authority to dispose of its property so as to prevent it from carrying on the business for which it was created, see:

*Missouri*: *Feld v. Roanoke Investment Co.*, 123 Mo. 613 (1894), (27 S. W. Rep. 635): "The officers of a corporation cannot, against the wishes of its stockholders or any one of them, sell and transfer the entire property from which it derives its emoluments

or which forms the basis of its business operations. To do so would be to commit a breach, if not of the express terms of the contract, of its implied terms, by which the general objects defined in its charter would be diverted and, in effect, destroyed."

*New York*: *People v. Ballard*, 134 N. Y. 269 (1892), (32 N. E. Rep. 54, 17 L. R. A. 737); *Blatchford v. Ross*, 54 Barb. 42 (1869); *Metropolitan El. R. Co. v. Manhattan R. Co.*, 14 Abb. N. C. 103 (1882); *Smith v. New York Consolidated Stage Co.*, 18 Abb. Pr. 419 (1864).

*Pennsylvania*: *Carter v. Producers Oil Co.*, 164 Pa. St. 463 (1894), (30 Atl. Rep. 391); *Balliet v. Brown*, 103 Pa. St. 554 (1883).

*Tennessee*: *Deaderick v. Wilson*, 8 Baxt. 108 (1874).

In *Manufacturers' Sav. Bank v. Big Muddy Iron Co.*, 97 Mo. 38 (1888), (10 S. W. Rep. 865), however, it was held that the directors of a corporation are justified in disposing of all its property if it is necessary to do so to obtain the means of meeting its obligations.

That the officers of a going corporation have no power to convey its entire manufacturing plant is manifest without authority, and is held in *Consolidated Water Power Co. v. Nash*, 109 Wis. 490 (1901), (85 N. W. Rep. 485).

the other, the relations between a corporation and its creditors. As said by Judge Peckham in *Vanderpoel v. Gorman*:<sup>1</sup> "The assignment of property by an insolvent corporation to pay its debts is a very different action from so disposing of its property when solvent, as to make its continued exercise of its franchises impossible."

In the absence of a controlling statute or by-law of the corporation, the directors have power to authorize an assignment of the property of an insolvent corporation for the benefit of its creditors.<sup>2</sup>

§ 113. Ratification by Stockholders of Sale by Directors. — While directors have no implied authority to sell the entire

<sup>1</sup> *Vanderpoel v. Gorman*, 140 N. Y. 563 (1894), (35 N. E. Rep. 932, 37 Am. St. Rep. 596).

<sup>2</sup> *Vanderpoel v. Gorman*, 140 N. Y. 563 (1894), (35 N. E. Rep. 932, 37 Am. St. Rep. 596). "The corporation had the power to make an assignment. It was a corporate act and neither the statute nor any by-law provided that it should be otherwise done than by the president and secretary and treasurer, under the authority of the board of directors. This sufficiently appears to have been so done and that is enough."

See also:

*Alabama*: *Chamberlain v. Bromberg*, 83 Ala. 576 (1887), (3 So. Rep. 434).

*Connecticut*: *Chase v. Tuttle*, 55 Conn. 455 (1887), (12 Atl. Rep. 874, 3 Am. St. Rep. 64).

*Illinois*: *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439 (1883).

*Indiana*: *De Camp v. Aylward*, 52 Ind. 468 (1876).

*Iowa*: *Buell v. Buckingham*, 16 Iowa 284 (1864), (85 Am. Dec. 516).

*Massachusetts*: *Sargent v. Webster*, 13 Metc. 497 (1847), (46 Am. Dec. 543).

*Michigan*: *Boynton v. Roe*, 114 Mich. 401 (1897), (72 N. W. Rep. 257).

*Minnesota*: *Tripp v. Northwestern Nat. Bank*, 41 Minn. 400 (1889), (43 N. W. Rep. 60).

*Missouri*: *Calumet Paper Co. v. Haskell Show Printing Co.*, 144 Mo. 331 (1898), (45 S. W. Rep. 1115, 66 Am. St. Rep. 425).

*New Jersey*: *Wilkinson v. Banerle*, 41 N. J. Eq. 635 (1886), (7 Atl. Rep. 514).

*Pennsylvania*: *Ardesco Oil Co. v. North American Oil, etc. Co.*, 66 Pa. St. 375 (1870).

*South Dakota*: *Wright v. Lee*, 2 S. D. 596 (1892), (57 N. W. Rep. 706).

*Texas*: *Birmingham, etc. Co. v. Freeman*, 15 Tex. Civ. App. 451 (1897), (39 S. W. Rep. 626).

*Utah*: *Cupit v. Park City Bank*, 20 Utah 292 (1899), (58 Pac. Rep. 839).

*Wisconsin*: *Goetz v. Knie*, 103 Wis. 366 (1899), (79 N. W. Rep. 401).

Most of these decisions are based upon State insolvency statutes. In West Virginia, however, a vote of the stockholders is necessary to authorize an assignment for the benefit of creditors. Action by the directors is insufficient.

*Kyle v. Wagner*, 45 W. Va. 349 (1898), (32 S. E. Rep. 213).

assets of a corporation, a sale made by them may be validated by the subsequent ratification of the stockholders.<sup>1</sup>

Ratification and authorization are governed by the same principles. A sale of corporate property which, in the first instance, requires unanimous consent, can only be made good by the approval of all the stockholders. A sale requiring the vote of a majority may be ratified by a majority.<sup>2</sup>

<sup>1</sup> In *Sheldon, etc. Co. v. Eickemeyer, etc. Co.*, 90 N. Y. 613 (1882), the Court of Appeals said: "In transferring the property of the corporation to pay its debts the trustees believed that they were acting within the scope of their authority, and the defendant accepted the transfer and received the property in satisfaction of its claim against the plaintiff, in the honest belief that it acquired good title thereto. If the trustees had no power, as the agents of the corporation, to transfer all its property, thus depriving it of the means of carrying on the business for which it was organized, it is but the case of an agent making a contract in excess of his authority. The act is voidable, not void. The principal may, nevertheless, affirm the act, and a ratification is equivalent to a prior authorization. If all the stockholders of this corporation had, with full knowledge, subsequently ratified the transfer and affirmed the settlement, the act — though beyond the powers given the trustees by the charter — could not be subsequently avoided by the stockholders, or by the corporation."

The conveyance under the authority of the directors, whose action is ratified subsequently by a majority of the stockholders, of the total assets of a private corporation in payment of its debts, operates as a valid conveyance of the property, as against other stockholders, in the absence of fraud, and when a longer continuance of the business would be prejudicial to all parties. *Hancock v. Holbrook*, 9 Fed. 353 (1881).

See also *Metcalf v. American School Furniture Co.*, 122 Fed. 115 (1903); *Hancock v. Holbrook*, 40 La. Ann. 53 (1888), (3 So. Rep. 351); *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159 (1879).

Where the directors of a mercantile corporation called a stockholders' meeting to consider the propriety of a sale of its business, at which less than one-third of the stock was represented, but a resolution was adopted instructing the directors to dispose of the business upon such terms as they should deem best, it was held that as the statutes fully provided for winding up the corporation in case its business was unprofitable, or in case it was obliged to suspend for want of funds, the directors should be enjoined, at the suit of a stockholder, from disposing of the assets, so as to prevent the corporation from carrying out the objects of its incorporation. *Hunt v. American Grocery Co.*, 81 Fed. 532 (1897).

A purchaser of stock after the ratification at a stockholders' meeting of a sale of the property of a corporation by its trustees cannot ordinarily maintain an action to set aside the sale, although the stock purchased was not voted at such meeting.

*Pitcher v. Lone Pine-Surprise Consol. Co.*, 39 Wash. 608 (1905), (81 Pac. Rep. 1047).

<sup>2</sup> Irregular action of the board of directors of a corporation in disposing of its property but which was within the corporate power may be validated by the ratification of the stockholders.

The approval by the stockholders of a sale made by the directors may also be inferred from their failure to object within a reasonable time.<sup>1</sup> In *Stokes v. Detrick*<sup>2</sup> the Supreme Court of Maryland said: "While it is well settled that the directors of a corporation cannot, ordinarily, alone sell and convey the whole of its property, yet it is equally true that, if such an unauthorized transfer is made, it may be ratified by the assent of the stockholders, and such assent may be inferred from their failure to protest against and promptly condemn the unauthorized acts of the officers of the corporation."

§ 114. **Remedies of Dissenting Stockholders in Case of Invalid or Unfair Sales. Voidable Sales.**<sup>3</sup> — A sale of the entire property of a prosperous corporation for purposes other than the winding up of its affairs, or an exchange of corporate assets for property entailing outside obligations, requires, for reasons elsewhere indicated, the unanimous consent of the stockholders.<sup>4</sup> Any such sale or exchange is *ultra vires* the majority and an infringement upon the rights of minority stockholders.

A dissenting stockholder has a right to stand upon the contract of association as made, and equity will afford him a remedy — preventive or annulling — against any acts of the majority beyond their powers.<sup>5</sup> It is entirely immaterial that

*Morrisette v. Howard*, 62 Kan. 463 (1901), (63 Pac. Rep. 756).

<sup>1</sup> *Balliet v. Brown*, 103 Pa. St. 554 (1883); *Stokes v. Detrick*, 75 Md. 256 (1892), (23 Atl. Rep. 846).

Ratification of an unauthorized act by acquiescence to be binding must be shown to have been with knowledge of all the material facts connected with the transaction.

*Morris v. Elyton Land Co.*, 125 Ala. 263 (1899), (28 So. Rep. 518).

<sup>2</sup> *Stokes v. Detrick*, 75 Md. 263 (1892), (23 Atl. Rep. 846).

<sup>3</sup> In this section the rights and remedies of dissenting stockholders are considered, not only with respect to invalid, unfair and voidable sales, but with respect to invalid exchanges of corporate property for stock in

other corporations. See *post*, §§ 118, 119, 120, 121 and 122.

<sup>4</sup> See *ante*, § 109: "*Sale of Entire Corporate Property by Unanimous Consent*;" *ante*, § 110: "*Sale of Entire Property of Prosperous Corporation by Majority Vote*;" *post*, § 118: "*Transfer of Entire Corporate Property without Unanimous Consent requires Monetary Consideration*."

<sup>5</sup> *United States v. Mason v. Pewabic Mining Co.*, 133 U. S. 50 (1890), (10 Sup. Ct. Rep. 224); *Mackintosh v. Flint, etc. R. Co.*, 34 Fed. 582 (1888). In *Dodge v. Woolsey*, 18 How. (U. S.) 331 (1855), Justice Wayne clearly states the general principles governing the application of preventive remedies by injunction, at the instance of stockholders, to restrain those administering the affairs of a

a proposed purchase or sale may, in the opinion of the court, be advantageous to such stockholder.<sup>1</sup> He alone can determine that. So his motive in bringing suit is of no importance.<sup>2</sup>

Where a majority of the stockholders of a corporation have power to dispose of its entire assets, they must act with fairness towards minority stockholders. A sale wherein the majority obtain, directly or indirectly, more favorable terms than the

corporation from doing acts amounting to a violation of its charter or from monopolizing its funds. And in the later leading case of *Hawes v. Oakland*, 104 U. S. 450 (1881), Justice Miller formally states the rules governing the grant of equitable relief to stockholders of corporations. See also *Mumford v. Ecuador Devel. Co.*, 111 Fed. 639 (1901); *Eldred v. American Palace Car Co.*, 96 Fed. 59 (1899).

*Connecticut*: *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304).

*Georgia*: *Central R., etc. Co. v. Collins*, 40 Ga. 582 (1869).

*Illinois*: *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320 (1892), (30 N. E. Rep. 667, 33 Am. St. Rep. 315).

*Missouri*: *Tanner v. Lindell R. Co.*, 180 Mo. 1 (1904), (79 S. W. Rep. 155).

*Montana*: *Forrester v. Boston, etc. Min. Co.* 21 Mont. 544 (1898), (55 Pac. Rep. 229, 353).

*New York*: *Abbott v. American Hard Rubber Co.*, 33 Barb. 578 (1861).

*Pennsylvania*: *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42 (1858), (72 Am. Dec. 664).

*Rhode Island*: *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881).

*England*: *Beman v. Rufford*, 1 Sim. (N. S.) 550 (1851); *Ware v. Grand Junction Water Co.*, 2 Russ. & Myl. 470 (1831); *Bagshaw v. Eastern Union R. Co.*, 7 Hare, 114

(1849). See also *Bird v. Bird's Patent Deodorizing, etc. Co.* 9 L. R. Ch. App. 358 (1874).

*Compare* *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.), 393 (1856), (66 Am. Dec. 490); *Hodges v. New England Screw Co.*, 1 R. I. 312 (1850), (53 Am. Dec. 624); *Dudley v. Kentucky High School*, 9 Bush (Ky.), 576 (1873).

<sup>1</sup> *Central R., etc. Co. v. Collins*, 40 Ga. 617 (1869): "We do not think the profitableness of this contract to the stockholders of the Central Railroad Co., . . . has anything to do with the matter. These stockholders have the *right*, at their pleasure, to stand on their contract. If the charters do not give to these companies the *right* to go into this new enterprise, any one stockholder has the right to object. He is not to be forced into an enterprise not included in the charter. That it will be to his interest is no excuse; that is for him to judge."

See also *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304); *Stevens v. Rutland, etc. R. Co.*, 29 Vt. 545 (1851); *Beman v. Rufford*, 1 Sim. (N. S.) 550 (1851).

<sup>2</sup> *Central R., etc. Co. v. Collins*, 40 Ga. 582 (1869); *Carson v. Iowa, etc. Co.*, 80 Iowa, 638 (1890), (45 N. W. Rep. 1068); *Elkins v. Camden, etc. R. Co.*, 36 N. J. Eq. 5 (1882); *Ramsey v. Gould*, 57 Barb. (N. Y.), 398 (1870); *Pender v. Lushington, L. R.* 6 Ch. 70 (1877).

minority may be avoided by the latter, or the majority may be compelled to account.<sup>1</sup> Upon similar principles, the courts will closely scrutinize a sale of corporate property effected by majority stockholders to another corporation, which they control or are interested in. Such a sale is not void nor constructively fraudulent. But if it is unfair to the minority, or if any unconscionable advantage of their position has been taken by the majority, the courts will not hesitate, at the suit of the minority, to set the sale aside. Regardless of the means employed, when it appears that "the majority have put something in their pockets at the expense of the minority" a court of equity will grant relief.<sup>2</sup> So where the directors of the vendor

<sup>1</sup> In *Ervin v. Oregon R., etc. Co.*, 27 Fed. 625 (1886), where a majority of the stockholders of a corporation merged its business and property with businesses and properties belonging to themselves and embarked the whole in a joint venture, Judge Wallace said (p. 632): "Applying these principles to the case in hand, although the minority of stockholders cannot complain merely because the majority have dissolved the corporation and sold its property, they may justly complain because the majority, while occupying a fiduciary relation towards the minority, have exercised their powers in a way to buy the property for themselves, and exclude the minority from a fair participation in the fruits of the sale. In the language of Mellish, L. J., in *Menier v. Hooper's Telegraph Works, L. R. 9 Ch. App. 354* (1874): 'The majority cannot sell the assets of the company, and keep the consideration, but must allow the minority to have their share of any consideration which may come to them.'"

For other somewhat similar cases where the courts have protected the interests of minority stockholders see *Buckley v. Big Muddy Iron Co.*, 7 Mo. App. 589 (1879); *Fougeray v. Cord*, 50 N. J. Eq. 185 (1899), (24 Atl. Rep. 499). See also *Hayden v.*

*Official Red Book, etc. Co.*, 42 Fed. 875 (1890). Compare *Goodwin v. Bodcaw Lumber Co.*, 109 La. 1050 (1902), (34 So. Rep. 74).

<sup>2</sup> In *Mumford v. Ecuador Devel. Co.*, 111 Fed. 643, (1901) Judge Coxe said: "Although a majority may lawfully make a contract with the company such contract will be scrutinized with much greater care than if made with a third party, and unless it appears that it was made honestly and for an adequate consideration a court of equity will interpose to prevent such contract from being used oppressively and in violation of the rights of the minority. It matters not in what form these rights are invaded; it is the business of equity to penetrate through subterfuges and discover the actual transaction stripped of its disguises. If then it shall appear, no matter what may be the machinery employed, that the majority have sold the corporate property to themselves for a wholly inadequate consideration a court of equity will grant relief to the minority who have thus been despoiled of their property."

In *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 335 (1892), (30 N. E. Rep. 667), (33 Am. St. Rep. 315) the Supreme Court of Illinois said: "The right of a majority of the

corporation are substantially interested in the vendee corporation, a sale of corporate assets will be annulled if unfair, and

stockholders to sell the corporate property can by no reasonable construction be held to involve the right to seize the property to their own use. A sale conducted, as it may be, fairly and openly, cannot, theoretically, operate to the prejudice of one stockholder more than to another. There is in such case no presumptive antagonism between the different stockholders. But where, under pretence of a sale to themselves, the majority seize the property and undertake to invest themselves with title, their interests are wholly hostile, for the gain of the one is the loss of the other."

Where a majority of the stockholders sell the corporate assets to another corporation owned by themselves, in violation of the rights of the minority the latter have an equitable lien upon the property sold to the extent of their interests.

*Ervin v. Oregon R., etc. Co.*, 27 Fed. 625 (1886).

In *Rothschild v. Memphis, etc. R. Co.*, 113 Fed. 476 (1902), where a majority stockholder of a corporation did not have the actual control of its affairs it was held that he did not occupy a trust relation toward the minority and, in the absence of fraud, might purchase the property of the corporation at a judicial sale. The Court said (p. 479): "Stockholders are not tenants in common of the property of the corporation, and a stockholder, as such, even though he owns a majority of the stock, does not occupy a trust relation toward the other stockholders, and he may deal with them or with the corporation in good faith. In order to establish a trust relation, the majority stockholder must actually control the affairs of the company for his own benefit and to the prejudice

of the minority stockholders. If he is not in control of the property, and does not mismanage it to the prejudice of the minority stockholders, he may purchase, if there is no actual fraud, the property of the corporation at a judicial sale for his own benefit, and he is not accountable to any other stockholder for the property so purchased. . . ." (p. 481) "It is true that every transaction of a majority stockholder with the corporation will be viewed by the courts with jealousy, and set aside on slight grounds; but it is not void, and, if the relations of the majority stockholder are fair and open, there is no rule which forbids his dealing with the corporation, and no presumption that such dealing is fraudulent. The actual control of the property, which is the basis in all of the cases of the trust relation, not existing, and the sale not having been brought about by the fraudulent action of the defendant, it did not, by its purchase, become a trustee for the complainant and other stockholders of the . . . company."

Where the majority of the stockholders of a corporation entered into an agreement for the sale of all its assets to another corporation in consideration of the payment of the debts of the selling company and an exchange of its shares for those of the purchasing company upon an agreed basis, and the latter company, although receiving a transfer of the property, failed to perform its part of the agreement and attempted to dispose of the stock it was entitled to under the agreement, it was held that there was sufficient evidence of fraud to warrant the issuance of a preliminary injunction.

*Eldred v. American Palace Car Co.*, 96 Fed. 59 (1899).

Where a corporation is prosperous



the burden is upon the directors to show its fairness.<sup>1</sup> And if the directors of the vendor corporation are likewise directors of the vendee corporation and thus control the action of both, a sale is voidable and will be set aside at the instance of a stockholder, regardless of its fairness.<sup>2</sup>

and no reason appears why it should be voluntarily dissolved and its assets sold, a court of equity will, at the instance of minority stockholders who allege that the dissolution and proposed sale constitute a scheme by the majority to "freeze out" the minority, restrain the same.

*Elbogen v. Gerbereux-Flynn Co.*, 30 Misc. (N. Y.) 264 (1900), (62 N. Y. Supp. 287).

See also *Russell v. Fuel Gas Co.*, 184 Pa. 102 (1898), (39 Atl. Rep. 21); *Devine v. Frankford Steel, etc. Co.*, 205 Pa. 114 (1903), (54 Atl. Rep. 578); *Glengarry Consol. Min. Co. v. Boehmer*, 28 Colo. 1 (1900), (62 Pac. Rep. 839).

<sup>1</sup> Directors of a corporation stand in a fiduciary relation to the stockholders, and will not be permitted to manage the corporation's affairs so as to give them an advantage over other stockholders. The courts will carefully scrutinize transactions between two corporations where the directors of one are largely interested in the stock of the other, although they are not necessarily fraudulent. "The law required of them the utmost good faith in their management and control of the corporate property."

*Hill v. Gould*, 129 Mo. 106, 112 (1895), (30 S. W. Rep. 181).

If a conveyance of corporate property is, in whole or part, for the benefit of one or more of the directors who acted in the board and voted for the resolution authorizing the conveyance, the same will, in a court of equity, be regarded as *prima facie* fraudulent and will be so declared unless it should be shown to be fair,

reasonable and wholly free from fraud.

*Sweeny v. Grape Sugar Refining Co.*, 30 W. Va. 443 (1887), (4 S. E. Rep. 431, 8 Am. St. Rep. 88).

<sup>2</sup> In *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 335 (1892), (30 N. E. Rep. 667, 33 Am. St. Rep. 315), the Court said: "It is a general rule, administered by courts of equity, that where one person has the power of disposition of the property of another without the consent of that other, he shall not be allowed to become personally interested in it himself — and this without regard to any question of fairness in the immediate transaction, — for he shall not be allowed to occupy a position where self-interest would tempt a betrayal of duty."

In *O'Connor Mining, etc. Co. v. Coosa Furnace Co.*, 95 Ala. 614, 618 (1891), (10 So. Rep. 290, 36 Am. St. Rep. 251), it was said: "The duty which disqualifies the directors from binding the corporation by a transaction in which they have an adverse interest, is one owing to the corporation which they represent, and to the stockholders thereof. A principal may consent to be bound by a contract made for him by an agent who, at the same time, represented an interest adverse to that of the principal. A *cestui que trust* may elect to confirm a transaction which he could have repudiated on the ground that the trustee had an interest in the matter not consistent with his trust relation. In like manner, dealings between corporations, represented by the same persons as directors, may be accepted as binding by each corporation and the stockholders thereof. The general

Where the majority stockholders, in violation of the rights of the minority, have sold all the assets of a corporation the minority are not bound to accept a *pro rata* share of the proceeds of the sale, nor shares of the vendee corporation in lieu thereof, but may insist upon the market value of their shares at the time of the sale; may follow the property and share in the profits arising from its use, or may, under some circumstances, have the sale set aside. Where, however, the sale has been carried into effect and the rights of innocent persons have intervened, the court may decline to annul the sale and leave the dissenting minority to their remedies at law.<sup>1</sup> It has

rule is, that such dealings are not absolutely void, but are voidable at the election of the respective corporations, or of the stockholders thereof. They become binding, if acquiesced in by the corporations and their stockholders."

The mere fact that directors sell the assets of a corporation to another corporation in which they are directors and stockholders does not render the transaction absolutely void.

*Manufacturers' Sav. Bank v. Big Muddy Iron Co.* 97 Mo. 38 (1888), (10 S. W. Rep. 965).

See also:

*United States: Worth Mfg. Co. v. Bingham*, 116 Fed. 791 (1902); *Miller v. Consolidated Lake Superior Co.*, 110 Fed. 480 (1901).

*Colorado: Morgan v. King*, 27 Colo. 539 (1900).

*Louisiana: Leathers v. Janney*, 41 La. Ann. 1120 (1889), (6 So. Rep. 884, 6 L. R. A. 661).

*Missouri: Hill v. Gould*, 129 Mo. 106 (1895), (30 S. W. 181).

*New Hampshire: Pearson v. Concord R. Co.*, 62 N. H. 537 (1883), (13 Am. St. Rep. 590).

*New York: Barr v. New York, etc. R. Co.*, 125 N. Y. 263 (1891), (26 N. E. Rep. 145).

*Oregon: Patterson v. Portland Smelting Works*, 35 Or. 96 (1899), (56 Pac. Rep. 407).

*Rhode Island: Wilson v. Central Bridge Props.*, 9 R. I. 590 (1870).

*Washington: Pitcher v. Lone Pine-Surprise, etc. Min. Co.*, 39 Wash. 608 (1905), (81 Pac. Rep. 1047).

<sup>1</sup> In *Tanner v. Lindell R. Co.*, 180 Mo. 1 (1904), (79 S. W. Rep. 155), the Court said (p. 21): "When the majority of stockholders against the will of the minority sell all the property of the corporation and thereby work a practical dissolution of it, the minority stockholders are not bound to take in payment for their stock a pro-rata share of the proceeds of the sale, or, in substitution therefor, the stock of another corporation, but, at their election, may have out of the proceeds of the sale, whether it be money or other property, the market value of their stock at the date of the sale of their proportional share of the proceeds, or they may follow the property into the hands of the purchaser and share in the profits arising from its use in the same ratio that they would have shared if the sale had not been made, and, if the transaction be made with bad faith, they may, under some circumstances, have the sale set aside and a rehabilitation of the corporation, or, if equity requires it, and the application is timely, they may have an injunction to arrest the transaction."

also been held that a court of equity will not set aside, at the instance of a minority stockholder, a sale which is voidable by reason of common directors in both corporations, unless such stockholder shows that he has sustained damages.<sup>1</sup>

§ 115. **Procedure in Stockholders' Actions.** — All the minority stockholders may join in a suit to enjoin the execution of a contract of sale, proposed by the majority and requiring unanimous consent — or for its cancellation if executed; or any less number of such stockholders may maintain the suit. In the latter case, in order to prevent a multiplicity of suits and that all parties interested shall, theoretically, be before the court, it is necessary that the stockholder — in case an individual stockholder acts — should institute the suit in behalf of himself and of other stockholders similarly situated.<sup>2</sup>

In this case, however, the Court, while stating the different remedies, held that although the sale in question infringed the rights of minority stockholders yet that, as a court of equity, it would not decree its rescission because, on account of intervening rights, such rescission would be productive of more injury than the refusal of it; that the dissenting stockholders had an adequate remedy at law for damages for the injury sustained and would be left to such remedy.

<sup>1</sup> *Smith v. Ferries, etc. R. Co.* (Cal. 1897) 51 Pac. Rep. 710, citing *Hill v. Nisbet*, 100 Ind. 341, 354 (1884) where the Court said: "The rule is well established that, unless under peculiar and exceptional circumstances, a court of equity will not interfere to set aside a transaction in itself voidable only, unless it appears that the complainant has sustained or may sustain some damages."

When the business of a corporation is unprofitable and the majority have authority to sell the corporate assets, a bill by a dissenting stockholder to restrain a proposed sale upon the ground of inadequacy of price, and praying for a public sale

under the direction of the court, will not be sustained in the absence of proof that a larger bid than the price arranged for could reasonably be expected at such public sale or that any person was ready to bid as much as that price.

*Phillips v. Providence, etc. Co.* 21 R. I. 302 (1899), (43 Atl. Rep. 598, 45 L. R. A. 560). The Court also said the fact that the sale was approved by a vote of 3675 to 75 tended to show the fairness of the price agreed upon.

<sup>2</sup> *United States v. Zabriskie v. Cleveland, etc. R. Co.*, 23 How. 395 (1859). See also *Metcalf v. American School Furniture Co.*, 122 Fed. 115 (1903).

*Illinois v. Whitney v. Mayo*, 15 Ill. 251 (1853).

*Massachusetts v. Peabody v. Flint*, 6 Allen, 52 (1863).

*New Hampshire v. March v. Eastern R. Co.*, 40 N. H. 548 (1860), (77 Am. Dec. 732).

*New York v. Blatchford v. Ross*, 54 Barb. 42 (1869).

*Vermont v. Stevens v. Rutland, etc. R. Co.*, 29 Vt. 545 (1851).

*England v. Clinch v. Financial Corp.*, L. R. 4 Ch. App. 117 (1868); *Taylor v. Salmon*, 4 Myl. & C. 134

All the actors, in transactions by which the rights of minority stockholders have been infringed, are proper parties defendant to suits at their instance.<sup>1</sup>

As a suit to set aside a sale of corporate property is for the benefit of the corporation and all its stockholders rather than for the exclusive benefit of the stockholder who institutes it, money compensation cannot, against his objection, be decreed to him.<sup>2</sup> Upon similar principles, it follows that a judgment in such a suit instituted by certain stockholders in behalf of the corporation is a bar to a subsequent suit by other stockholders for the same purpose based upon the same grounds.<sup>3</sup>

While a rule of the federal courts, established to prevent collusive transfers of stock merely for the purpose of conferring jurisdiction, requires that a plaintiff stockholder should have been such at the time when the transaction complained of took place,<sup>4</sup> the prevailing rule in England and this country

(1838); *Mozley v. Alston*, 1 Phill. 790 (1847); *Beman v. Rufford*, 1 Sim. (N. S.) 550 (1851); *Winch v. Birkenhead, etc. R. Co.*, 5 De G. & S. 562 (1852).

*Compare*, however, *Hoole v. Great Western R. Co.*, L. R. 3 Ch. App. 262 (1867).

<sup>1</sup> *Ervin v. Oregon R., etc. Co.*, 27 Fed. 625 (1886).

<sup>2</sup> *Morris v. Elyton Land Co.* 125 Ala. 263 (1899), (28 So. Rep. 513).

Where the only relief prayed for in a suit by a minority stockholder is the annulment of the sale of corporate property and such relief cannot be granted, it is held that there is no basis for granting other relief depending upon the affirmance of the sale, the validity of which the bill expressly repudiates.

*Tanner v. Lindell R. Co.*, 180 Mo. 1 (1904), (79 S. W. Rep. 155).

<sup>3</sup> *Hearst v. Putnam Min. Co.* 28 Utah 184 (1904), (77 Pac. Rep. 753, 66 L. R. A. 784).

<sup>4</sup> Supreme Court equity rule 94 is as follows: "Every bill brought by one or more stockholders in a corporation against the corporation and

other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance."

For cases in the federal courts construing the rule see *Lafayette Co. v. Neely*, 21 Fed. 738 (1884); *Evans v. Union Pacific R. Co.*, 58 Fed. 497 (1893); *Symmes v. Union Trust Co.*, 60 Fed. 830 (1894).

A bill attacking the validity of the purchase by one corporation of the property of another comes within the operation of Supreme Court Equity rule 94 as one founded upon a right existing in favor of the corporation, and, under such rule, is not maintainable in the absence of specific statements of the efforts of the plaintiff to secure action through the directors and the cause of their inaction.

is that a transferee, taking his stock since that time, may sue.<sup>1</sup>

The general rule of equity that a stockholder must first seek relief within his corporation, manifestly has no application when the minority seek relief from the wrongful acts of the majority. The majority will hardly attack sales which they, themselves, have made or authorized. Under such circumstances, demand that the corporation take action is unnecessary before bringing suit.<sup>2</sup>

§ 116. **Defences to Stockholders' Actions. Estoppel. Laches.**—Sales of corporate property, for an unlawful purpose, are *ultra vires* of the corporation. Sales of corporate property, for a purpose requiring unanimous consent, are *ultra vires* of the majority. Principles of estoppel may make good the latter but not the former.<sup>3</sup>

Worth Mfg. Co. v. Bingham, 116 Fed. 785 (1902).

<sup>1</sup> Winsor v. Bailey, 55 N. H. 218 (1875); Ervin v. Oregon R., etc. Co., 35 Hun (N. Y.), 544 (1885), s. c. 28 Hun, 269 (1882); Chicago v. Cameron, 22 Ill. App. 91 (1886); Seaton v. Grant, L. R. 2 Ch. App. 459 (1867).

In Georgia the rule of the federal courts has been adopted. Alexander v. Searcy, 81 Ga. 536 (1889), (8 S. E. Rep. 630, 12 Am. St. Rep. 337). See also Moore v. Mining Co., 104 N. C. 534 (1889), (10 S. E. Rep. 679).

In Hollins v. St. Paul, etc. R. Co., 29 N. Y. St. Rep. 208 (1889), (9 N. Y. Supp. 909), it was held that a stockholder could not object to a transfer of corporate property for stock in another corporation, decided upon before he bought his stock; that he stood in the shoes of those from whom he had bought.

In Bloxham v. Metropolitan R. Co., L. R. 3 Ch. App. 337 (1868), it was held to be immaterial that the stock was purchased for the purpose of bringing suit.

<sup>2</sup> Davis v. Gemmell, 70 Md. 376, (1889), (17 Atl. Rep. 259); Chicago

Hansom Cab Co. v. Yerkes, 141 Ill. 320 (1892), (30 N. E. Rep. 667, 33 Am. St. Rep. 315); Nathan v. Tompkins, 82 Ala. 437 (1887), (2 So. Rep. 747); Forrester v. Boston, etc. Min. Co., 21 Mont. 544 (1898), (55 Pac. Rep. 229, 353).

<sup>3</sup> In Kent v. Quicksilver Mining Co., 78 N. Y. 185 (1879), Judge Folger said: "When it is a question of the right of a stockholder to restrain the corporate body within its express or incidental powers, the stockholder may in many cases be denied, on the ground of his express assent or his intelligent though tacit consent to the corporate action. If there be a departure from statutory direction, which is to be considered merely a breach of trust to be restrained by a stockholder, it is pertinent to consider what has been his conduct in regard thereto. A corporation may do acts which affect the public to its harm, inasmuch as they are *per se* illegal or are *malum prohibitum*. Then no assent of stockholders can validate them. It may do acts not thus illegal, though there is a want of power to do them, which affect only the interests of the stockholders.

Where the want of a stockholder's assent affects the validity of a sale, he may be estopped from setting it up. By participating in the transfer of corporate property,<sup>1</sup> or by acquiescing and failing for an unreasonable time to take steps to set it aside,<sup>2</sup> a stockholder may be estopped from taking action.

They may be made good by the assent of the stockholders, so that strangers to the stockholders, dealing in good faith with the corporation, will be protected in a reliance upon those acts."

*Symmes v. Union Trust Co.*, 60 Fed. 855 (1894): "In reference to the acts and conduct of complainants and their participation and acquiescence in the various transactions, it must be remembered that the doctrine of *ultra vires* has two separate and distinct phases, — one, where the public or creditors are concerned, which has no application to this case; the other, where the question is between the stockholders and the corporation, or between it and its stockholders and third parties dealing with it and through it with them."

<sup>1</sup> Where minority stockholders who opposed a transfer of corporate assets for stock, subscribed for their proportion under protest, and permitted the purchasing corporation to transact business for eighteen months, it was held that they were then estopped to ask for a rescission. *Post v. Beacon Pump, etc. Co.*, 84 Fed. 371 (1898).

A stockholder who accepts his shares of the stock cannot complain of the transaction. *Feld v. Roanoke Inv. Co.*, 123 Mo. 603 (1894), (27 S. W. Rep. 635). See also *Glymont Imp. Co. v. Toller*, 80 Md. 278 (1894), (30 Atl. Rep. 651); *Hoene v. Pollak*, 118 Ala. 617 (1897), (24 So. Rep. 349, 72 Am. St. Rep. 189, 43 L. R. A. 376).

Stockholders, after voting for and approving a sale or purchase, cannot be heard to complain thereof in equity.

*McGeorge v. Big Stone Gap Imp't. Co.*, 57 Fed. 262 (1893); *Burr v. Pittsburgh, etc. Co.*, 51 Fed. 33 (1892).

Where at a stockholders' meeting a plan for the sale of the assets of the corporation to another corporation, partly for cash and partly for stock, was presented, explained and unanimously approved, and at a subsequent meeting the officers were authorized "to complete the sale" and executed a deed, it was held that a stockholder who was present at the first meeting was bound by its action and could not refuse the stock of the purchasing corporation in part payment of his shares.

*Carr v. Rochester Tumbler Co.*, 207 Pa. 392 (1904), (56 Atl. Rep. 945).

Where a corporation, without the consent of all its stockholders, sold all its property to another corporation for stock in the latter, it was held that the exchange could be annulled at the instance of a stockholder of the former corporation who did not participate in the transaction. It was also held that the fact that the purchasing corporation had given its bonds in exchange for certain bonds of the vendor corporation did not estop such stockholder from taking steps to set aside the transfer.

*Morris v. Elyton Land Co.*, 125 Ala. 263 (1899), (28 So. Rep. 513).

See also generally as to estoppel against stockholders, *Sheldon, etc. Co. v. Eickemeyer, etc. Co.*, 90 N. Y. 667 (1882); *Berry v. Broach*, 65 Miss. 450 (1888), (4 So. Rep. 117).

<sup>2</sup> Sir John Romilly in *Gregory v. Patchett*, 33 Beav. 602 (1864), thus stated the position of stockholders

"Acquiescence is an implied sanction of the sale,"<sup>1</sup> and, as a defence, is essentially the same as laches, although the former carries the idea of tacit approval and the latter of neglect or delay.

An injunction will not be granted, at the instance of a minority stockholder, to restrain a sale where such stockholder, by his laches, has permitted the interests of innocent persons to intervene so that it cannot be granted without inflicting serious injuries.<sup>2</sup>

The defence of estoppel involves both knowledge and unreasonable delay on the part of the stockholder who brings the suit,<sup>3</sup> or the prior holder of his shares,<sup>4</sup> although the means of knowledge, readily available, may be, in legal effect, equivalent to knowledge.<sup>5</sup> No rule can be laid down for determining what length of time will constitute unreasonable delay. It will depend upon the facts and circumstances of each case.<sup>6</sup>

who acquiesce and outstay their time: "Shareholders cannot lie by, sanctioning, or by their silence at least acquiescing in, an arrangement which is *ultra vires* of the company to which they belong, watching the result; if it be favorable and profitable to themselves, to abide by it and insist on its validity, but if it prove unfavorable and disastrous, then to institute proceedings to set it aside." See also *Watt's Appeal*, 78 Pa. St. 370 (1875); *Fort Worth Pub. Co. v. Hitson*, 80 Tex. 216 (1891), (14 S. W. Rep. 846).

<sup>1</sup> *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881). *Evans v. Smallcomb*, L. R. 3 H. L. 249 (1868).

<sup>2</sup> *Tanner v. Lindell R. Co.*, 180 Mo. 1 (1904), (79 S. W. Rep. 155).

<sup>3</sup> *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553 (1859).

<sup>4</sup> A transferee stands in no better position than the holder of the stock at the time of the transaction. *Brown v. Duluth, etc. R. Co.*, 53 Fed. 889 (1893). *Re Syracuse, etc. R. Co.*, 91 N. Y. 1 (1883).

<sup>5</sup> *Jessup v. Illinois Central R. Co.*,

43 Fed. 483 (1890). See also *Taylor v. Railroad Co.*, 4 Woods (U. S.), 575 (1882).

<sup>6</sup> *Connecticut*: Seven years' delay a bar. *Banks v. Judah*, 8 Conn. 145 (1830), (the earliest reorganization case). Six months' delay after the annual meeting not a bar. *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304).

*Georgia*: *Alexander v. Searcy*, 81 Ga. 536 (1888), (8 S. E. Rep. 630, 12 Am. St. Rep. 337), four years' delay a bar to stockholder's suit.

*Louisiana*: *Hancock v. Holbrook*, 40 La. Ann. 53 (1888), 3 So. Rep. 351, two years' delay a bar.

*Massachusetts*: *Snow v. Boston, etc. Co.*, 158 Mass. 325 (1893), (33 N. E. Rep. 588), one year a bar. *Peabody v. Flint*, 88 Mass. 52 (1863), three and a half years a bar.

*Minnesota*: *Pinkus v. Minneapolis Linen Mills*, 65 Minn. 40 (1896), (67 N. W. Rep. 643), two years a bar.

*Missouri*: *Descombes v. Wood*, 91 Mo. 196 (1886), (4 S. W. Rep. 82, 60 Am. Rep. 239) four years a bar.

*Pennsylvania*: *Ashhurst's Appeal*,

§ 117. **Effect of Sale of Entire Corporate Property.** — A corporation, having been created, is not dissolved, in contemplation of law, without some legislative or judicial act — or act in pursuance of legislative authority — extinguishing its franchises. So long as they exist, the corporation exists. Consequently, while the sale of the entire property of a corporation may render it unable to fulfil the purposes of its organization, it does not dissolve it. "A corporation may exist without property."<sup>1</sup>

60 Pa. St. 290 (1869), seven years a bar.

*Rhode Island*: Boston, etc. R. Co. v. New York, etc. R. Co., 13 R. I. 260 (1881), twelve years a bar.

*England*: In *Re Pinto Silver Min. Co.*, L. R. 8 Ch. 273 (1877), Lord Justice James held three years' delay a bar and said: "But when a person, having knowledge of what is being done, assents by his trustees to the transfer of the property of the company to another company, being aware that the former company was in course of winding up, and takes no step during the whole of that winding up, it is utterly out of the question that he should be at liberty to come, after the lapse of years, and upset all that has been done."

<sup>1</sup> *Price v. Holcomb*, 89 Iowa, 137 (1893), (56 N. W. Rep. 407): "The sale of all the property may have the effect of terminating the business for which the corporation was organized, but it does not dissolve it. Such a sale no more dissolves the corporation than would the giving of a mortgage that might ultimately result in all the property being taken from the corporation."

See also:

*Illinois*: *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439 (1883); *Brufett v. Great Western R. Co.*, 25 Ill. 353 (1861).

*Maryland*: *State v. Bank of Maryland*, 6 Gill & J. 205 (1834), (26 Am. Dec. 561).

*Missouri*: *Kansas City Hotel Co. v. Sauer*, 65 Mo. 279 (1877); *Hill v. Fogg*, 41 Mo. 563 (1867).

*New York*: *Brickerhoff v. Brown*, 7 Johns Ch. 217 (1823).

*North Carolina*: *Pinchback v. Bessemer Min. etc. Co.*, 137 N. C. 171 (1904), (49 S. E. Rep. 106).

*Texas*: *Island City Sav. Bank v. Sachtleben*, 80 Tex. 420 (1887); (3 S. W. Rep. 733, 26 Am. St. Rep. 759).

And see note to 99 Am. Dec. 333, "Sale by corporation of all its assets and effect thereof."

In *Coler v. Tacoma R. etc. Co.*, 65 N. J. Eq. 347 (1903), (54 Atl. Rep. 413), however, it was held that the arrangement there proposed, consisting of the transfer of the property and franchises of a corporation, in consideration of the distribution of the shares of the purchasing corporation among the stockholders of the vendor company, with a provision for a cash payment to dissenting stockholders, amounted to a dissolution of the vendor corporation within the meaning of the New Jersey statute, and could be legally carried out only according to the provisions of such statute.

So it has been held under peculiar provisions of the statutes of Tennessee that an educational institution is dissolved by the conveyance of its property and franchises to another institution which assumes its obligations.



## II. *Exchange of Property of One Corporation for Stock of Another*

§ 118. **Transfer of Entire Corporate Property without Unanimous Consent requires Monetary Consideration.** — Upon the winding up of the affairs of a corporation, every stockholder has a right to insist that the property of the corporation be converted into money and that the proceeds be distributed.<sup>1</sup> He has a right to require the valuation of the corporate property to be fixed by a sale.

Similarly, it is the right of every stockholder to demand that sales of corporate assets made preliminary to, and for the purposes of, liquidation shall be for money. He cannot be compelled to accept "chips and whetstones" instead of cash. Whether the exchange of one species of property for another is even a step towards liquidation depends entirely upon their comparative marketableness. An exchange is not a sale.

A transfer of all the property of one corporation for stock in another is an exchange. Its legality depends upon two considerations:

(1) The power of the *corporation* to acquire stock in another corporation.

(2) The power of the *majority* to authorize such transfer.

§ 119. **Exchange of Property for Stock *ultra vires*.** — A private corporation, by the unanimous consent of its stockholders, may exchange its assets for any other property it has power to acquire. The validity of a transfer of the property of one corporation for stock in another therefore depends,

*State v. U. S. Grant University*, 115 Tenn. 238 (1905), (90 S. W. Rep. 294).

And compare the decision in the very recent case of *Rochester R. Co. v. City of Rochester*, 205 U. S. 236, 255 (1907), (27 Sup. Ct. Rep. 469), where the Supreme Court said: "The law does not expressly dissolve the selling corporation, but it leaves it without stock, officers, property or franchises. A corporation without shareholders, without officers to

manage its business, without property with which to do business, and without the right lawfully to do business, is dissolved by the operation of the law which brings this condition into existence."

<sup>1</sup> *Mason v. Pewabic Mining Co.*, 133 U. S. 50 (1890), (10 Sup. Ct. Rep. 224). See also cases cited in notes to § 120, *post*: "*Exchange of Property for Stock Infringement of Rights of Dissenting Stockholders.*"

primarily, upon the power of the former corporation to acquire the stock.

The general rule that one corporation has no implied authority to acquire and hold stock in another corporation, and the exceptions thereto, are considered at length in another part of this treatise.<sup>1</sup> Unless the corporation transferring its property has express statutory authority to acquire stock, or the circumstances are such as to bring it within an exception to the rule, a transfer of corporate property for stock in another corporation is *ultra vires*.<sup>2</sup>

It would seem, however, that the objection of *ultra vires* to an exchange of property for stock when *all* the stockholders agree, might be avoided by directly distributing the stock among the stockholders instead of delivering it to the corporation. If the rights of creditors are protected and stock-

<sup>1</sup> See *post*, Part IV.: "*Corporate Stockholding and Control*."

<sup>2</sup> A New Jersey corporation entered into an agreement with a corporation of the State of Washington wherein it agreed to transfer to the latter corporation all its property and franchises, except the franchise of being a corporation, in consideration that the latter should issue to it its shares of fully paid-up stock to an agreed amount, and should pay to its stockholders who refused to accept such stock a sum in cash in lieu thereof. It was *held*, upon a bill filed by a stockholder of the New Jersey corporation, that the consummation of the arrangement should be restrained for the reason, among others, that the Constitution and judicial decisions of the State of Washington which make it unlawful for any corporation to hold stock and exercise the rights of a stockholder in a corporation of that State, apply to foreign as well as to domestic corporations.

*Coler v. Tacoma R. etc. Co.*, 65 N. J. Eq. 347 (1903), (54 Atl. Rep. 413).

A corporation having power under

its charter "to take stock" in other corporations cannot, without the consent of all its stockholders, transfer all its property to another corporation in consideration of stock in the latter corporation to be distributed among its stockholders. Such a transaction is *ultra vires* the transferring corporation.

*Morris v. Elyton Land Co.*, 125 Ala. 263 (1899), (28 So. Rep. 513).

A transfer of all the property of a corporation to a foreign corporation in consideration of the latter corporation assuming the obligations of the former and agreeing to turn over its entire capital stock in exchange for the shares of the former corporation — provision being made for paying cash to dissenting stockholders — is neither a "sale" nor an "exchange," and is unauthorized by the laws of Montana.

*Forrester v. Boston, etc. Min. Co.*, 21 Mont. 544 (1898), (55 Pac. Rep. 229, 353).

For further consideration of this subject see *post*, § 281, "*Incidental Power to take Stock in Exchange for Corporate Assets*."

holders agree, no one else can complain of a donation by a private corporation for the direct pecuniary benefit of its stockholders.<sup>1</sup>

§ 120. **Exchange of Property for Stock Infringement of Rights of Dissenting Stockholders.** — A corporation, having the power to acquire stock in other corporations, may, in ordinary transactions, exercise it in the same manner as other powers.

But a transfer of the entire property of a corporation is an extraordinary transaction requiring unanimous consent, except for liquidating purposes, and for those purposes requiring a pecuniary consideration.

A majority of the stockholders cannot authorize the transfer of the corporate assets for stock in another corporation.<sup>2</sup> They

<sup>1</sup> A transfer of the property of a corporation for stock in another corporation not objected to by any stockholder or creditor cannot be questioned by any one, except the State in a proper proceeding.

Read *v. Citizens St. R. Co.*, 110 Tenn. 316 (1903), (75 S. W. Rep. 1056).

<sup>2</sup> *United States*: In *Post v. Beacon Vacuum Pump, etc. Co.*, 84 Fed. 375 (1898), Judge Putnam said: "The minority has a lawful right to maintain that the contractual relations which it established with a corporation whose shareholders they became does not include a contractual relation with any other corporation."

See also *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896), (31 L. R. A. 415); *Eason v. Buckeye Brewing Co.*, 51 Fed. 156 (1892).

*Alabama*: *Elyton Land Co. v. Dowdell*, 113 Ala. 186 (1896), (20 So. Rep. 981, 59 Am. St. Rep. 105): "It may be that a private business corporation may sell out its entire property, by and with the consent of less than all its stockholders, for the purposes of paying its debts or for the purposes of dissolution and

settlement, but when this is the purpose, it must be clearly understood, and the terms and conditions of the sale must be within the contractual relations between the corporation and its creditors or shareholders. There can be no presumption that a creditor or stockholder of the dissolved corporation will accept, in payment of his demand, anything but money. He cannot be required to do so arbitrarily." See also *Morris v. Elyton Land Co.*, 125 Ala. 263 (1899), (28 So. Rep. 513).

*Connecticut*: *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 350 (1895), (3 Atl. Rep. 833, 28 L. R. A. 304).

*Illinois*: *Harding v. American Glucose Co.*, 182 Ill. 628 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738).

*Maryland*: *Glymont Imp. Co. v. Toller*, 80 Md. 278 (1894), (30 Atl. Rep. 651).

*Montana*: *Forrester v. Boston, etc. Min. Co.*, 21 Mont. 544 (1898), (55 Pac. Rep. 229, 353).

*Missouri*: *Feld v. Roanoke Investment Co.*, 123 Mo. 614 (1894), (27 S. W. Rep. 635): "Nor can the stock of such new corporation be forced

cannot force the minority, against their will, into a new company nor compel them to elect between so entering and losing their interests.<sup>1</sup>

upon the dissenting stockholders in payment of their stock in the original company, who are entitled to payment in money."

*New York: Frothingham v. Barney*, 6 Hun, 372 (1876): "They had no right to exchange the assets of the old association for the corporate stock of any corporations, without the consent of all the stockholders.

Equally were they without authority in making this partial exchange, without such consent. Stockholders of the old association could not thus, against their will, be forced into relations with the new company."

See also *Taylor v. Earle*, 8 Hun, 1 (1876); *People v. Ballard*, 134 N. Y. 269 (1892), (32 N. E. Rep. 54).

*Rhode Island: Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881).

*South Dakota: Summers v. Glenwood Gold, etc. Min. Co.*, 15 S. D. 20 (1901), (86 N. W. Rep. 749).

<sup>1</sup> Notwithstanding the rule stated in the text, transfers of the entire property of corporations, authorized only by a majority of their stockholders, in exchange for the stock of other corporations have been repeatedly made — often in the guise of a "reorganization" — and have sometimes received the approval of the courts. Thus in *Sawyer v. Dubuque Printing Co.*, 77 Iowa, 242 (1889), (42 N. W. Rep. 300), it was held that where a corporation could not carry on a business with profit, and was approaching serious financial embarrassment, the sale, without fraud and in good faith, of all its property to a rival corporation whose paid-up stock was given in payment, afforded no ground of complaint to a stockholder who was not notified of,

nor present at, the meeting at which the transfer was decided upon. In this case, however, the question whether an exchange of property for stock was valid was not passed upon by the Court. And in *Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*, 54 Fed. 759 (1893), it was assumed by Judge Jackson that an exchange of property for stock was a *sale*, and, from this wrong premise, the conclusion was reached that, under statutory power to sell, a transfer of property for stock by the prescribed majority left the minority remediless.

Moreover, in the recent case of *Metcalf v. American School Furniture Co.*, 122 Fed. 126 (1903) Judge Hazel said: "I am, therefore, of opinion that the weight of authority supports the view that, where a corporation obtains by its charter the right to dispose of its property and to dissolve its corporate existence, it has the power to accept stock in another corporation in payment of the purchase price, provided the transaction is *bona fide*."

In *Germer v. Triple-State Natural Gas, etc. Co.*, 60 W. Va. 143 (1906), (54 S. E. Rep. 509), the Court said: "Did the stockholders have the right, under the laws of West Virginia, to vote and sell all the property of the corporation, and take in payment the stock and bonds of another corporation? . . . It will be seen that the section provides that holders of 60 per centum of the outstanding stock of the corporation may sell, transfer, or assign in good faith all of its property and assets, and, while it does not expressly and in terms authorize the corporation to take in payment therefor the stock or bonds of another corporation, yet, with the full power to sell, transfer, or assign in good

A possible exception to this rule may arise where the stock, taken upon an exchange, has an established market value, so that it may fairly be considered an *equivalent for money*. In such a case there is, practically, a sale upon a monetary consideration.<sup>1</sup>

In order to avoid the objection that dissenting stockholders cannot be forced into a new corporation, reorganization plans have often provided that stockholders who do not choose to go into the new or purchasing company may take a stated sum of money in lieu of the shares to which they would be entitled. The objection to a plan of this character is that the majority have no right to fix the value of the property of the

faith all of its property and assets under the said section, it would seem clear that under the provisions of the Code of 1899, as amended by the acts of 1901, the corporation has full power to subscribe for or purchase the stock, bonds, or securities of any joint-stock company. This it can do, upon a majority vote of the stock, by plain implication. Having the right to sell, transfer, and assign all its property . . . and having the right to subscribe for, or purchase the stock, bonds or other securities of any joint-stock company, it would follow as a necessary sequence that it could take the one in payment for the other."

For other cases where the courts have, for various reasons, approved the exchange of the assets of one corporation for stock in another, see *Buford v. Keokuk, etc. Packet Co.*, 3 Mo. App. 159 (1876); *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.), 393 (1856), (66 Am. Dec. 490); *Hodges v. New England Screw Co.*, 1 R. I. 312 (1850); *Wilson v. Æolian Co.*, 64 App. Div. (N. Y.) 337 (1901), (72 N. Y. Supp. 150).

<sup>1</sup> The decision in *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.), 393 (1856), cannot be justified upon principle. In this case the Court said

(p. 405): "Nor can we see anything in the proposed sale to a new corporation, and the receipt of their stock in payment, which makes the transaction illegal. It is not a sale by a trustee to himself, for his own benefit; but it is a sale to another corporation for the benefit and with the consent of the *cestuis que trust*, the old stockholders. The new stock is taken in lieu of money, to be distributed among those stockholders who are willing to receive it, or to be converted into money by those who do not desire to retain it. Being done fairly, and not collusively, as a mode of payment for the property of the corporation, that transaction is not open to valid objection by a minority of the stockholders."

The rights of minority stockholders cannot be made to depend upon their ability to convert into money stock which has no established market value — is not regularly bought and sold. Compare *Easun v. Buckeye Brewing Co.*, 51 Fed. 156 (1892); *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833); *Buford v. Keokuk, etc. Packet Co.*, 3 Mo. App. 159 (1876). Compare also decision of the Chancellor in *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 415 (1871).

minority.<sup>1</sup> As said by Mr. Justice Miller in *Mason v. Pewabic Mining Co.*:<sup>2</sup> "It is further said that, in the present case, the dissenting stockholders are not compelled to enter into a new corporation with a new set of corporators, but have their option, if they do not choose to do this, to receive the value of their stock in money. It seems to us that there are two insurmountable objections to this view of the subject. The first of these is that the estimate of the value of the property which is to be transferred to the new corporation and the new set of stockholders is an arbitrary estimate made by this majority, and without any power on the part of the dissenting stockholders to take part, or to exercise any influence, in making this estimate. They are, therefore, reduced to the proposition that they must go into this new company, however much they may be convinced that it is not likely to be successful, or whatever other objection they may have to becoming members of that corporation, or they must receive for the property which they have in the old company a sum which is fixed by those who are buying them out. The injustice of this needs no comment. If this be established as a principle to govern the winding up of dissolving corporations, it places any unhappy minority, as regards the interest which they have in such corporation, under the absolute control of a majority, who may themselves, as in this case, constitute the new company, and become the purchasers of all the assets of the old company at their own valuation."

§ 121. **Appraisal of Stock of Dissenting Stockholders.** — Several of the statutes, already referred to, providing for the appraisal of the shares of dissenting minority stockholders, are probably broad enough to be available in aid of a reorganization through the transfer of corporate assets in exchange for stock.<sup>3</sup> Theoretically, such statutes when constitutionally

<sup>1</sup> *Mason v. Pewabic Mining Co.*, 133 U. S. 50 (1890), (10 Sup. Ct. Rep. 224). See also *Post v. Beacon Vacuum Pump etc. Co.*, 84 Fed. 375 (1898), where it was said: "There is no right in law to compel it [the minority] to elect between such new contractual relations and the loss of its shares in the old

corporation, or compensation for them on any arbitrary basis which a reorganization may give."

<sup>2</sup> *Mason v. Pewabic Mining Co.*, 133 U. S. 58 (1890), (10 Sup. Ct. Rep. 224).

<sup>3</sup> See *ante*, § 57: "*Statutory Provisions for Appraisal of Stock.*"

The English statute applicable in

applicable may do exact justice to a dissenting stockholder. He is given the option of entering the new corporation or selling out for the value — fixed by appraisal — of his interest in the old. The result is apparently so equitable that it has been intimated by the Supreme Court of the United States that a court of equity, without such a statute, might be justified in itself appraising the interests of minority stockholders.<sup>1</sup> It is, however, fundamentally wrong in principle and should not be extended by judicial legislation.

If the business of a corporation is not to be continued according to the contract of association, each stockholder is entitled to his *actual* distributive share of the proceeds of the corporate property. A court of equity cannot equitably put him off by securing for him "*a theoretical distributive share*" fixed by appraisal.<sup>2</sup>

case of transfers of corporate property for stock is contained in Companies Act 1862 (25 and 26 Vict. ch. 89, § 161): "Where any company is proposed to be or is in the course of being wound-up altogether voluntarily, and the whole or a portion of its business and property is proposed to be transferred or sold to another company, the liquidators of the first mentioned company may, with the sanction of a special resolution of the company by whom they were appointed, . . . receive in compensation or in part compensation for such transfer or sale, shares, policies or other like interests in such other company, for the purpose of distribution, amongst the members of the company being wound up."

Section 161 also provides that dissentient stockholders may require the liquidator to purchase their interests.

Section 162 provides for determining the price by arbitration.

For construction of this statute see *In re* London, etc. Bread Co., 62 L. T. Rep. 224 (1890); *In re* Imperial Mercantile Credit Ass'n, L. R. 12 Eq. 504, (1871); *Southall v. British Mutual Life Assur. Soc.*, L. R. 6 Ch. App. 614

(1871); *In re* Irrigation Co., L. R. 6 Ch. App. 176 (1871); *Clinch v. Financial Corp.*, L. R. 4 Ch. App. 117 (1868).

See also *Pennsylvania* appraisal statute, Laws 1901, Act No. 20, p. 53.

<sup>1</sup> *Mason v. Pewabic Min. Co.*, 133 U. S. 50 (1890), (10 Sup. Ct. Rep. 224). See conclusion of opinion of Justice Miller and opinion of Justice Bradley. See also *Lauman v. Lebanon Valley R. Co.*, 30 Pa. St. 42 (1858), (72 Am. Dec. 685); *McVicker v. Ross*, 55 Barb. (N. Y.) 247 (1869).

<sup>2</sup> 4 *Thompson Corp.* § 4543. In *Morris v. Elyton Land Co.*, 125 Ala. 263, 278 (1899), (28 So. Rep. 513), the Supreme Court of Alabama said: "It would necessarily and logically follow from this principle that a moneyed compensation to the complaining shareholder for the value of his stock could not against his objection be decreed as his relief. To do so would be nothing more nor less than compelling the shareholder to sell his stock, which a court of equity has not the power to do. That it would be to the benefit of the corporation and all other shareholders in it to let the transaction stand and

§ 122. **Stock received upon Exchange belongs primarily to Corporation.** — When the property of a corporation is duly transferred to another corporation for its shares of stock, the title to such shares — the consideration for the transfer — vests, in the absence of express agreement otherwise, in the vendor corporation as a distinct corporate entity. The stock so acquired becomes the property of the corporation — in lieu of the property transferred — and the stockholders of the corporation have only an indirect interest therein, through their interest in the corporation as a whole. The stockholders own the corporation, but the corporation owns the stock. The powers of the corporation, under its charter, will determine the question whether the stock so acquired can be permanently held, or whether the immediate winding up of the corporation's affairs and distribution of the stock is necessary. But whether distributed sooner or later, the stockholders take only through the distribution.<sup>1</sup>

compel the dissentient to accept compensation for his stock, is an argument that rests upon no higher grounds than that of expediency. In the administration of justice by the courts, principle should never be sacrificed at the altar of expediency."

<sup>1</sup> In *Kohl v. Lilienthal*, 81 Cal. 378 (1889), (20 Pac. Rep. 401), two corporations sold their property to a third corporation, under an agreement that its stock should be delivered in payment, and stockholders of a vendor company brought suit asking that the stock should be divided among them. The Court held that as the former companies had not passed out of existence nor been dissolved, the new stock, received in payment for their property, belonged to them and could not be divided among their stockholders until after the dissolution of the corporations in the manner provided by statute.

It appears, however, that there was an agreement that the new stock should be divided among the stockholders and the decision is opposed

to the weight of authority except when placed upon the ground that the laws of California permit the liquidation of corporations only in the statutory way. See also *Martin v. Zellerbach*, 38 Cal. 309 (1869), (99 Am. Dec. 365).

In *Schaake v. Eagle Automatic Can Co.*, 135 Cal. 472 (1902), (63 Pac. Rep. 1025, 67 Pac. Rep. 759) the California Supreme Court followed the earlier decisions in that State and held that a transfer by a subsisting corporation of all its property to another corporation for the sole consideration of the issue of stock of the vendee corporation directly to the stockholders of the vendor company was, in effect, the attempted distribution of the assets of the latter corporation among its stockholders in violation of the section of the California Code (Civil Code § 309) providing that no distribution of the capital of a corporation, other than dividends from profits, shall be made except upon the dissolution of the corporation.



By unanimous consent, however, a corporation may make a donation of its property. If creditors are provided for and stockholders are satisfied, no one else can complain. Under like conditions, a corporation, exchanging its property for stock in another corporation, may enter into a valid agreement that such stock, instead of being delivered to it — the corporation — shall be directly divided among its stockholders *pro rata*. This amounts to a liquidation of the corporation's affairs by unanimous consent, but, in the absence of a controlling statute, there is no legal objection to it; and, between the parties, it is a contract, upon a valid consideration, for the benefit of a third party — the stockholders — which generally, under modern codes, gives such party a right of action upon it.<sup>1</sup> When such an express agreement is made, there-

Where the property of a corporation was transferred to another corporation in consideration of the delivery to the president of the transferring corporation in trust for its stockholders of shares of stock of the transferee corporation, it was held that as the former corporation was entitled to such stock as between it and its stockholders, it was a necessary party to a suit to compel the president to account.

*Knickerbocker v. Conger*, 110 App. Div. 125 (1905), (97 N. Y. Supp. 127).

Where the property of a corporation has been sold and conveyed, the fact that the purchaser then requires an assignment of all the shares of the vendor corporation does not make the transaction a sale of stock instead of property; and the vendor corporation, and not its stockholders, is entitled to the consideration for the sale.

*Pendery v. Carleton*, 87 Fed., 41 (1898).

In *Holst v. Sydney, etc. Coal, etc. Co.*, 69 L. T. Rep. 132 (1893), a corporation by its articles of association was authorized to sell or dispose of all or any part of its assets for cash or

for the stock or obligations of another corporation. It agreed to sell all its property in consideration partly of a sum in cash, and partly of the procuring by the purchasing company of a waiver from its (the the vendor company's) stockholders of their right to participate in the cash sum received. It was held that the proposed sale was not within the powers of the vendor corporation, the Court saying: "I think that the sale or disposition contemplated by the memorandum of association is one under which the whole consideration given by the purchaser, whether that consideration consists of cash, shares or obligations, will come into the hands of the company, so as to be dealt with by the members or directors of that company, or the liquidator, if the company is being wound up."

<sup>1</sup> In *Anthony v. American Glucose Co.*, 146 N. Y. 407 (1895), (41 N. E. Rep. 23), a new corporation having been organized by the transfer to it of the property of several corporations, upon an agreement that payment for the transfer should be made by apportioning to the original stockholders the whole of the stock of the

fore, the stockholders may maintain an action directly against the purchasing corporation to compel the delivery of the stock to them, but, without such agreement, an action can be maintained only by and for the corporation itself.

§ 122a. **Effect of Execution of Ultra Vires Contract for Exchange of Property for Stock.** — While it may be beyond the powers of a corporation to make a conveyance of all its property to another corporation in consideration of the issue to it of stock of the latter, yet if the transfer has been made and the contract fully executed, the corporation itself cannot maintain an action to set aside the transfer and recover back the property.<sup>1</sup>

new corporation not reserved for the use of the treasury, certain stockholders in one of the original corporations brought an action against the new corporation for a delivery of its stock to them, and it was held that the action was maintainable against the new corporation, and that such stockholders were not to be turned over for relief to their original corporation after all its functions had ceased, although it might not be wholly dead — it appearing that the new corporation owed a contract duty directly to the individual corporators and not to their corporate entities.

The Court said (p. 413): "We have, of late, refused to be always and utterly trammelled by the logic derived from corporate existence where it only serves to distort or hide the truth, and I think we should not hesitate in this case to reject the purely technical defence attempted. For nothing is plainer than that the transfer of the property and business of the five original companies to the new company to be organized was upon an agreement between the corporators of them all that payment for the transfer should be made by apportioning to the original stockholders the whole of the stock of the new company, not re-

served for the use of the treasury. That agreement is not denied by anybody, and every word and every act of all the companies, and of each and all of the corporators, have proceeded upon that assumption. The companies, as corporate entities, could not, alone and without the consent of their constituent members, make a transfer which was intended to end their whole practical business existence, and it was agreed by such companies when they made the written contract among themselves that the refusal of any one corporator, in any one company to give his consent to the transfer should turn the proposed sale into a mere lease. The authority of the corporations to sell and make a valid agreement of sale to which the new company could become a party, was upon the explicit and understood condition that the new stock should be issued in exchange for the old stock to the several corporators, and the necessary consent of the stockholders was given upon that express condition." See also *Hatch v. American Union Tel. Co.*, 9 Abb. N. C. (N. Y.) 223 (1881); *Wilson v. Æolian Co.* 64 App. Div. (N. Y.) 337 (1901), (72 N. Y. Supp. 150).

<sup>1</sup> *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543 (1869), (99 Am. Dec. 300).

§ 122b. **Remedies of Dissenting Stockholders in Case of Exchange of Property for Stock.** — The legal and equitable principles governing the remedies of dissenting stockholders in the case of invalid and unfair sales determine the remedies of stockholders who object to the exchange of the assets of their corporation for stock in another corporation. These principles have already been fully examined and further consideration is believed to be unnecessary. The same is true with respect to the procedure in stockholders' actions and the defences thereto.<sup>1</sup>

### III. *Rights and Remedies of Creditors.*

§ 123. **Liability of Purchasing Corporation for Debts of Vendor Company. Assumption of Obligations.** — A corporation in selling its entire property, with the approval of all or a majority of its stockholders, — as the occasion may require, — is governed by the same general principles of law applicable to

An exchange of the property of one corporation for stock in another which has been fully executed cannot be rescinded by the former corporation, or at the suit of a stockholder *suing in its right*, on the ground that it was *ultra vires*.

*Metcalf v. American School Furniture Co.*, 122 Fed. 115 (1903). See also *Wentworth v. Braun*, 78 App. Div. (N. Y.) 634 (79 N. Y. Supp. 489).

In *Savings & Trust Co., v. Bear Valley Irr. Co.*, 112 Fed. 693 (1902) the Court said (p. 701): "Property delivered under a void deed or contract may be recovered, or compensation therefor enforced, when, in order to maintain such recovery, it is not necessary to have recourse to the contract and is permitted only because of the desire of the courts to do justice, as far as possible, to the party who has made payment or delivered property under a void agreement, and which in justice he ought to recover. . . . But when

property is delivered and the consideration therefor paid, under and in pursuance of a void contract; when, in other words, the agreement is no longer executory but has been executed, — the courts leave the parties precisely where they have placed themselves."

See also *City of Spokane v. Amsterdamsch Trustees*, 22 Wash. 172 (1900), (60 Pac. Rep. 141); *Goodwin v. Bodcaw Lumber Co.*, 109 La. 1050 (1902), (34 So. Rep. 74).

For consideration of the effect of *ultra vires* sales of the franchises and property of quasi-public corporations see *Cumberland Tel., etc. Co. v. City of Evansville*, 127 Fed. 187 (1903). See also *post*, ch. XXII; "*Ultra Vires and Voidable Railroad Leases.*"

<sup>1</sup> See *ante*, § 114: "*Remedies of, Dissenting Stockholders in Case of Invalid or Unfair Sales*"; § 115: "*Procedure in Stockholders' Actions*"; § 116: "*Defences to Stockholders' Actions. Estoppel. Laches.*"

natural persons. It cannot transfer its property in fraud of its creditors. It may not so dispose of all its assets as to leave nothing for its creditors, and if it attempts such transfer the creditors may follow the property. But it may, in good faith, for a valuable consideration, sell its entire property to another corporation, and the purchaser will take the property free from all incumbrances, except specific liens and equitable liens of which it has notice, and will not be liable in any way for the debts of the vendor company.<sup>1</sup> The purchase price takes the place of the property sold, as respects creditors, and they have no rights of action, legal or equitable, against the purchaser or the property.

The doctrine that the property of a corporation is a trust fund for the payment of its debts does not prevent its transfer in good faith for a valuable consideration.<sup>2</sup> As said by Mr. Justice Field in *Fogg v. Blair*:<sup>3</sup> "That doctrine only means that the property must first be appropriated to the payment of the debts of the company before any portion can be dis-

<sup>1</sup> *United States*: *Gray v. National Steamship Co.*, 115 U. S. 116 (1885), (5 Sup. Ct. Rep. 116).

*Arkansas*: *Sappington v. Little Rock, etc. R. Co.*, 37 Ark. 23 (1881).

*District of Columbia*: *Capital Tract. Co. v. Offut*, 17 App. D. C. 292 (1900).

*Illinois*: *Brufett v. Great Western R. Co.*, 25 Ill. 353 (1861).

*Iowa*: *Warfield v. Marshall, etc. Co.*, 72 Iowa, 666 (1887), (34 N. W. Rep. 467, 2 Am. St. Rep. 263).

*Kentucky*: *Chesapeake, etc. R. Co. v. Griest*, 85 Ky. 619 (1887), (4 S. W. Rep. 323, 30 Am. & Eng. R. Cas. 149).

*Missouri*: *Hagemann v. Southern El. Co.*, 202 Mo. 249 (1907), (100 S. W. Rep. 1081); *Barrie v. United Rys. Co.*, 125 Mo. App. 96 (1907), (102 S. W. Rep. 1078); *Powell v. North Missouri R. Co.*, 42 Mo. 63 (1867).

*Nebraska*: *Campbell v. Farmers', etc. Bank*, 49 Neb. 143 (1896), (68 N. W. Rep. 344).

*Tennessee*: *First National Bank v.*

*North Alabama, etc. Co.*, 91 Tenn. 12 (1891), (18 S. W. Rep. 400).

*Texas*: *Abilene Cotton Oil Co.*, (Tex. Civ. App. 1907), 91 S. W. Rep. 607.

*Wisconsin*: *Pennison v. Chicago, etc. R. Co.*, 93 Wis. 344 (1896), (67 N. W. Rep. 70).

As to equitable liens see *Union Pacific R. Co. v. McAlpine*, 129 U. S. 305 (1889), (9 Sup. Ct. Rep. 286).

A corporation buying all the property of another corporation and assuming its name is not identical with it. *Huggins v. Milwaukee Brewing Co.*, 10 Wash. 579 (1895), (39 Pac. Rep. 152). *Compare*, however, *Island City Savings Bank v. Schat-tchen*, 67 Tex. 420 (1887), (3 S. W. Rep. 733); *Lehigh Mining, etc. Co. v. Kelly*, 64 Fed. 401 (1894).

<sup>2</sup> *Barrie v. United Rys. Co.* 125 Mo. App. 96 (1907), (102 S. W. Rep. 1078), citing this section.

<sup>3</sup> *Fogg v. Blair*, 133 U. S. 541 (1890), (10 Sup. Ct. Rep. 338).

tributed by the stockholders; it does not mean that the property is so affected by the indebtedness of the company that it cannot be sold, transferred or mortgaged to *bona fide* purchasers for a valuable consideration, except subject to the liability of being appropriated to pay that indebtedness. Such a doctrine has no existence.”<sup>1</sup>

<sup>1</sup>THE TRUST FUND DOCTRINE CONCERNING CORPORATE ASSETS.

1. *The Doctrine. Its Development.*

The doctrine that the property of a corporation, including unpaid subscriptions to its capital stock, constitutes a trust fund for the payment of its debts, upon which creditors have an equitable lien except as against *bona fide* purchasers for value, is stated in many cases. Thus, for example, the New York Court of Appeals has said (*Cole v. Millerton Iron Co.*, 133 N. Y. 168 (1892), (30 N. E. Rep. 847, 28 Am. St. Rep. 615)): “The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien both as against the stockholders and all transferees except those purchasing in good faith and for value.”

This doctrine originated in a *dictum* of Judge Story in *Wood v. Dummer*, 3 Mason 308, decided in 1824, and was followed to such an extent that it became known as the “American doctrine.” The courts found it a convenient basis for making corporate assets meet corporate liabilities. Thus it was applied:

(1) To compel subscribers to pay in their stock subscriptions when required to pay corporate obligations and to prevent the release or cancellation of such subscriptions.

(2) To prevent the distribution of corporate property among stockholders leaving debts unpaid.

(3) To prevent conveyances of corporate property to third persons without consideration.

(4) To follow corporate property into the hands of stockholders or third persons.

(5) To prevent preferences among creditors—the doctrine being that the trust fund was for the equal benefit of all creditors.

The following are among the more recent cases where the doctrine has been stated and applied:

*Connecticut*: *Buck v. Ross*, 68 Conn. 31 (1896), (35 Atl. Rep. 763, 57 Am. St. Rep. 60); *Crandall v. Lincoln*, 52 Conn. 73 (1884), (52 Am. Rep. 560).

*Illinois*: *Singer v. Hutchinson*, 183 Ill. 606 (1900), (56 N. E. Rep. 388, 75 Am. St. Rep. 133). Also *Coleman v. Howe*, 154 Ill. 458 (1895), (39 N. E. Rep. 725, 45 Am. St. Rep. 133); *Clapp v. Peterson*, 104 Ill. 26 (1882).

*Maine*: *In re Brockway Mfg. Co.*, 89 Me. 121 (1896), (35 Atl. Rep. 1012, 56 Am. St. Rep. 401).

*New Jersey*: *Wetherbee v. Baker*, 35 N. J. Eq. 501 (1882).

*New York*: *Hurd v. New York etc. Laundry Co.* 167 N. Y. 89 (1901), (60 N. E. Rep. 327); *Bartlett v. Drew*, 57 N. Y. 587 (1874).

*North Carolina*: *Marshall Foundry Co. v. Killain*, 99 N. C. 501 (6 S. E. Rep. 680, 6 Am. St. Rep. 539).

*Ohio*: *Rouse v. Merchants' Nat. Bank.*, 46 Ohio St. 493 (1889), (22 N. E. Rep. 293, 15 Am. St. Rep. 644, 5 L. R. A. 378).

*Tennessee*: *Memphis Barrel, etc. Co. v. Ward*, 99 Tenn. 172 (1897), (42 S. W. Rep. 13, 63 Am. St. Rep. 825).

*Texas*: *Lyons-Thomas Hardware*

The principle that a purchasing corporation is not responsible for the debts of its vendor does not, in any way, interfere

Co. v. Perry Stove Mfg. Co., 86 Tex. 143 (1893), (24 S. W. Rep. 16, 22 L. R. A. 802).

2. *Objections to the Doctrine.*

The trust fund doctrine cannot be justified upon principle. The relation of a solvent corporation to its creditors is simply that of a debtor. There is no element of trusteeship about it. It holds and may dispose of its property like an individual. Its power of disposition is wholly inconsistent with the existence of a trust. As said by the Circuit Court of Appeals for the Eighth Circuit in *New Hampshire Sav. Bank v. Richey*, 121 Fed. 956 (1903): "It is now well settled that no such relation as that of trustee and *cestui que trust* exists between a corporation and its general creditors. So long as a corporation is solvent and remains in control of its property and assets, it may deal therewith and dispose of the same like an individual, subject only to such limitations upon its powers as may have been imposed by its charter. The general creditors of a corporation are not, like the beneficiaries in a trust, the equitable owners of the corporate property, nor have they any greater interest therein than the creditors of natural persons have in the property of their debtors. Creditors of both kinds are entitled to insist that their debtors shall not make a voluntary or otherwise fraudulent conveyance of their property; but beyond this, in the absence of an express lien created by contract, they have no interest, legal or equitable, in their debtor's property, or right to control that free disposition of the same which is incident to ownership."

Upon principle it is equally difficult to see how an insolvent corporation stands in any trust relation

to its creditors. A trust implies two estates — legal and equitable — one vested in a trustee, the other belonging to a beneficiary. But a corporation has and must have both the legal and equitable title. Solvent or insolvent, all the decisions admit that it may convey good title to a *bona fide* purchaser for value. Its power is wholly inconsistent with a trust. It seems clear, therefore, that corporate property is not held in trust in any proper sense of the term. And if the trust only relates to the administration of the affairs of a corporation when it is being wound up it has little effect or meaning. That creditors are then to be paid before stockholders is a matter of legal right not dependent upon any trust fund doctrine.

The existence of a trust fund doctrine is not necessary for the protection of the rights of creditors. Fraudulent conveyances can be reached without its application. They are invalid when made by individuals as well as corporations. Subscriptions to capital stock rest upon contract and are reached in behalf of creditors by appropriate proceedings where the trust fund doctrine is not recognized. Releasing subscriptions would amount to giving away property in fraud of creditors. In fact the majority of cases applying the trust fund doctrine might have been determined the same way by applying the principles of law governing fraudulent and voluntary conveyances. This is, of course, not true where the trust fund doctrine has been applied as a basis for holding preferential conveyances invalid. But the weight of authority supports the view that preferences are not invalid unless prohibited by statute.

with its right to make such contracts as it may deem expedient. It may, as a part of the consideration, assume and agree

3. *The Doctrine as limited by the Weight of Authority.*

That the trust fund doctrine has no application in the case of a solvent corporation is practically admitted by the Supreme Court of the United States in *McDonald v. Williams*, 174 U. S. 397, 401 (1898) (19 Sup. Ct. Rep. 743): "When a corporation is solvent the theory that its capital is a trust fund upon which there is any lien for the payment of its debts has in fact very little foundation. No general creditor has any lien upon the fund under such circumstances, and the right of the corporation to deal with its property is absolute so long as it does not violate its charter or the law applicable to such corporations." See also *New Hampshire Sav. Bank v. Richey*, *supra*.

But the Supreme Court still clings to the doctrine in a modified form in the case of insolvent corporations. Thus in *Wabash, etc. R. Co. v. Ham*, 114 U. S. 594 (1885), (5 Sup. Ct. Rep. 1081) it said: "The property of a corporation is doubtless a trust fund for the payment of its debts in the sense that when the corporation is lawfully dissolved and all its business wound up, or when it is insolvent, all its creditors are entitled in equity to have its debts paid out of the corporate property before any distribution thereof among the stockholders. It is also true in the case of a corporation as in that of a natural person, that any conveyance of the property of the debtor, without authority of law, made in fraud of existing creditors, is void as against them."

And in *Hollins v. Brierfield Coal etc. Co.*, 150 U. S. 383 (1893), (14 Sup. Ct. Rep. 127) it was said: "Whatever of trust there is arises

from the peculiar and diverse equitable rights of the stockholders as against the corporation and in its property and their conditional liability to its creditors. It is rather a trust in the administration of the assets after possession by a court of equity than a trust attaching to the property as such, for the direct benefit of either creditor or stockholder."

See also *Chattanooga, etc. R. Co. v. Evans*, 66 Fed. 809 (1895).

In view of these decisions, therefore, it must be said that according to the weight of authority a trust exists in the case of an insolvent corporation whose affairs are being wound up, in the sense that its effects must be distributed equally among the creditors in satisfaction of their claims before any distribution among the stockholders can be made.

Cases from State courts, some of which follow the Supreme Court, and some of which wholly reject the trust fund doctrine, follow:

*Alabama*: *O'Bear Jewelry Co. v. Volfer*, 106 Ala. 205 (1894), (17 So. Rep. 525, 54 Am. St. Rep. 31, 28 L. R. A. 707), overruling earlier decisions.

*Arkansas*: *Worthen v. Griffith*, 59 Ark. 562 (1894), (28 S. W. Rep. 286, 43 Am. St. Rep. 50).

*Indiana*: *Levering v. Bimel*, 146 Ind. 545 (1897), (45 N. E. Rep. 775); *First Nat. Bank v. Dovetail Body, etc. Co.* 143 Ind. 550 (1895), (40 N. E. Rep. 810, 52 Am. St. Rep. 435).

*Minnesota*: *Hospes v. Northwestern Mfg., etc. Co.*, 48 Minn. 174 (1892), (50 N. W. Rep. 1117, 31 Am. St. Rep. 637, 15 L. R. A. 470).

*Missouri*: *Schufeldt v. Smith*, 131 Mo. 280 (1895), (31 S. W. Rep. 1039, 52 Am. St. Rep. 628). See also *Barrie v. United Rys. Co.*, 125

to pay the debts of the vendor company;<sup>1</sup> or, what is equivalent, may purchase the property subject to the payment of all the indebtedness of the vendor.<sup>2</sup> In either case the creditors have a legal or equitable right of action against the purchaser.<sup>3</sup>

Mo. App. 96 (1907), (102 S. W. Rep. 1078).

*Wisconsin*: Slack *v.* Northwestern Nat. Bank, 103 Wis. 57 (1899), (79 N. W. Rep. 51, 46 Am. St. Rep. 834).

<sup>1</sup> *Iowa*: Benesh *v.* Mill Owners Mut., etc. Ins. Co., 103 Iowa, 465 (1897), (72 N. W. Rep. 674).

*Kansas*: Baker *v.* Harpster, 42 Kan. 511 (1889), (22 Pac. Rep. 415).

*Michigan*: Rehberg *v.* Tontine Surety Co., 131 Mich. 135 (1902) (91 N. W. Rep. 132).

*Nebraska*: Tecumseh National Bank *v.* Best, 50 Neb. 518 (1897), (70 N. W. Rep. 41); Austin *v.* Tecumseh National Bank, 49 Neb. 412 (1896), (68 N. W. Rep. 628, 35 L. R. A. 444).

*New York*: Fernschild *v.* Yuengling Brewing Co., 154 N. Y. 667 (1898), (49 N. E. Rep. 151); Clokey *v.* International etc. Co., 28 Misc. 326 (1899), (59 N. Y. Supp. 878).

*North Carolina*: Friedenwald *v.* Asheville Tobacco Works, 117 N. C. 544 (1895), (23 S. E. Rep. 490).

*Tennessee*: Wall *v.* Chattanooga Co., 38 S. W. Rep. 278 (1896); Planters Ins. Co. *v.* Wickes, 4 S. W. Rep. 172 (1887).

Where a corporation transfers all its property to another corporation and the consideration passes to trustees for the benefit of the stockholders of the former company which is thus rendered unable to pay its debts, it is held that the purchasing corporation is liable for a debt of the vendor — all the facts being known to it before the purchase.

Carsten *v.* Hofins, 44 Wash. 456 (1906), (87 Pac. Rep. 631).

<sup>2</sup> In Chicago, etc. R. Co. *v.* Lundstrom, 16 Neb. 254 (1884), (20 N. W.

Rep. 198, 49 Am. Rep. 718), the property was bought, under the Nebraska statute, subject to "all liens, incumbrances or indebtedness" existing against the vendor corporation, and in Plainview *v.* Winona, etc. R. Co., 36 Minn. 505 (1887), (32 N. W. Rep. 749), the purchase was made "subject to all demands, claims and rights of action." In both cases the purchasing company was held liable.

<sup>3</sup> Such an assumption of debts would, in many States, give the creditor a right of action at law — it being a contract, upon a valid consideration, for the benefit of a third party. But when an action at law cannot be maintained, equity will grant relief. Thus a bond executed by one corporation to another whose entire property it had purchased, under which it covenanted to pay all the debts of the obligee, and to fulfil all its obligations, was held to create a direct and primary liability upon the part of the purchaser in favor of a person who had a contract with the vendor corporation which would be enforced in equity, but not at law. In this case (Goodyear Shoe Mach. Co. *v.* Dancel, 119 Fed. 694 (1902), s. c. 144 Fed. 679 (1906)) Judge Wallace said: "The complaint alleges that the defendant (a Maine corporation) purchased the letters patent from the Goodyear Company (a Connecticut corporation) and in an instrument of assignment to it, and in consideration thereof, agreed to assume all the obligations of the Goodyear Company to pay the annuity provided for in the contract between the latter and Dancel. This averment is admitted by the answer. The effect of this agreement was to create the relation of principal and



Such right of action, however, is based entirely upon the assumption clause of the contract, and the fact that the purchaser has agreed to pay certain debts does not make it liable for others.<sup>1</sup>

Whether the remedy of a creditor in the federal courts upon an assumption clause in a contract of purchase is at law or in equity depends upon the law of the forum.<sup>2</sup>

§ 124. **Fraudulent Sales.** — The general rules of law relating to fraudulent conveyances are equally applicable to corporations and individuals. Conveyances in which actual fraud appears are, manifestly, void.<sup>3</sup> Transfers, constructively fraud-

surety between the defendant and the Connecticut corporation, and as between these parties the defendant became primarily liable for the obligations arising from the contract of the Goodyear Company with Dancel; and upon the equitable doctrine that a creditor shall have the benefit by subrogation of any obligation or security given by the principal to the surety for the satisfaction of the debt the plaintiffs, if this action had been brought in equity, would have been entitled to enforce the covenant of the defendant."

In *Connecticut* a creditor cannot maintain an action at law upon the assumption clause in a contract of purchase, but when the assets of a corporation are transferred to another, under an agreement containing such a clause, equity has jurisdiction to appoint a receiver for the vendee corporation to enforce such clause against the purchasing corporation for the benefit of the creditors of the vendor company.

*Barber v. International, etc. Co.*, 73 Conn. 587 (1901), (48 Atl. Rep. 758).

In *Illinois* when a corporation, in purchasing the assets of another corporation, assumes the latter's debts, a creditor of the vendor may sue the vendee at law.

*Central Electric Co. v. Sprague Electric Co.*, 120 Fed. 925 (1902).

When one corporation transfers all its assets to another corporation which assumes all indebtedness, bondholders of the vendor corporation become creditors of the vendee. But such bondholders have no equitable lien on the assets received from the vendor corporation (except upon the securities pledged to secure the bonds), superior to other creditors whose claims have arisen subsequent to such transfer.

*Blake v. Domestic Mfg. Co.*, 38 Atl. Rep. 241 (N. J. Ch. 1897). See also *Columbus, etc. R. Co. Appeals*, 109 Fed. 177 (1901).

<sup>1</sup> *Fernschild v. Yuengling Brewing Co.*, 154 N. Y. 667 (1898), (49 N. E. Rep. 151). See also *Hall v. Herter*, 83 Hun (N. Y.), 19 (1894), (31 N. Y. Supp. 692).

<sup>2</sup> *Central Electric Co. v. Sprague Electric Co.*, 120 Fed. 925 (1902) and cases cited.

<sup>3</sup> Where an insolvent corporation sold all its property to another corporation in consideration of mortgage bonds issued by the purchasing corporation upon the property so conveyed, without any provision being made for the payment of the debts of the insolvent corporation, and thereupon the stockholders of the latter divided the bonds among themselves, it was held that the sale was a fraudulent conveyance and

ulent when made by individuals, are of the same character when made by corporations. From the nature of corporations, however, intercorporate sales sometimes present cases of constructive fraud of their own kind.

Where the assets of a corporation are transferred for stock in another company, if the stock received has a market value and may fairly be considered an equivalent for money, and the transfer is made, in all respects, in good faith, it cannot be set aside by creditors. The shares of stock take the place of the property sold and are liable for the debts of the corporation. Creditors have no ground of complaint. The fund for their benefit is merely changed in form. But, as a general rule, the transfer of corporate assets for stock, whether to a stranger corporation or to a new corporation formed by the stockholders of the old, will be treated as invalid as to creditors, and may be set aside as in fraud of their rights.<sup>1</sup> A corpora-

would be set aside at the instance of the creditors of the grantor corporation.

*Fort Payne Bank v. Alabama Sanitarium*, 103 Ala. 358 (1893), (15 So. Rep. 618).

Where the president of a corporation sold all its lands to another corporation organized by him with no assets for no actual consideration, and the purchasing corporation thereupon, at the instance of the president, executed a mortgage upon such land to secure an issue of bonds, it was held that the sale was fraudulent as against the creditors of the vendor corporation.

*Bramblet v. Commonwealth Land etc. Co.*, (Ky. 1904), 83 S. W. Rep. 599.

<sup>1</sup> *United States*: In *Hibernia Ins. Co. v. St. Louis, etc. Transp. Co.*, 13 Fed. 518 (1882), Judge McCrary said: "A corporation, unlike a natural person, by disposing of all its property, may not only deprive itself of the means of paying its debts, but may deprive itself of corporate existence and place itself beyond the reach of process of law. At all events, equity

will not permit the owners of one corporation to organize another, and transfer from the former to the latter all the corporate property, without paying all the corporate debts." In his concurring opinion in this case, Judge Treat said (p. 521): "If the new company has paid the full value of the property acquired, then it may possibly not be answerable; but if it merely issued to the old its stock therefor, why should it not, at least to the extent of that stock, which represents value for property acquired, meet the obligations to which such stock should fairly be held subject?"

Also *Chattanooga, etc. R. Co. v. Evans*, 66 Fed. 810 (1895); *Blair v. St. Louis, etc. R. Co.*, 22 Fed. 36 (1884).

*California*: *San Francisco, etc. R. Co. v. Bee*, 48 Cal. 398 (1874).

*New Jersey*: *Couse v. Columbia Powder Mfg. Co.*, 33 Atl. Rep. 297 (1895).

*Tennessee*: Where a new corporation is organized, through the efforts of the officers of another corporation, for the purpose of acquiring its

tion which pays only with its own stock does not take as a purchaser for value, without notice, but is put upon inquiry as to the debts of the corporation making the transfer.<sup>1</sup>

A corporation cannot, directly or indirectly, turn over its property to its stockholders at the expense of its creditors. Upon this principle a conveyance of the entire property of an insolvent corporation, under an arrangement whereby the purchase price — in money, bonds or stock — is to be distributed directly to the stockholders of the vendor corporation, is fraudulent and void as to creditors.<sup>2</sup>

Where directors of an insolvent corporation are also in the

property, and the transfer is made upon the agreement of the new company to issue to the old a part of its stock, the transaction is void as against the creditors of the old corporation. *Vance v. McNabb Coal, etc. Co.*, 92 Tenn. 47 (1892), (20 S. W. Rep. 424).

Where a transfer of the assets of one corporation to another for stock in the latter is void a reconveyance of the property cannot be treated as fraudulent as to creditors of the original grantee.

*Summers v. Glenwood Gold, etc. Min. Co.*, 15 S. D. 20 (1901), (86 N. W. Rep. 749).

<sup>1</sup> A corporation which purchases all the property of another company, knowing that such company is insolvent, under an arrangement by which a large part of the purchase price will be placed beyond the reach of the creditors, if there are any, is under a duty to inquire as to the existence of unsecured creditors, and is chargeable with all knowledge which such an inquiry would disclose. *Chattanooga, etc. R. Co. v. Evans*, 66 Fed. 810 (1895).

<sup>2</sup> Where the stockholders of an insolvent corporation convey all its property to another corporation in consideration of mortgage bonds issued by the purchaser on the property, and, without providing for

the debts, divide the bonds, *pro rata*, among themselves, such transfer is a fraud on creditors. *Fort Payne Bank v. Alabama Sanitarium*, 103 Ala. 358 (1894), (15 So. Rep. 618).

A provision, in the transfer of the assets of one corporation to another, that stock in the purchasing corporation shall be issued to the stockholders of the vendor corporation renders the transfer fraudulent and void as to creditors, being, in effect, a transfer of property by a debtor with a reservation of an interest therein to itself. *Montgomery Web Co. v. Dienelt*, 133 Pa. St. 585 (1890), (19 Atl. Rep. 428; 19 Am. St. Rep. 663).

A transfer by a corporation of all its property to another corporation, in consideration of the assumption of debts and the issuance of stock, which is carried out by the delivery of such stock to individual stockholders of the grantor, is *prima facie* fraudulent as to creditors. *Couss v. Columbia Powder Mfg. Co.* (N. J. 1895), 33 Atl. Rep. 297.

See also *Grenell v. Detroit Gas Co.*, 112 Mich. 73 (1897), (70 N. W. Rep. 413); *Jones v. Arkansas Mechanical and Agricultural Co.*, 38 Ark. 17 (1881); *Chattanooga, etc. R. Co. v. Evans*, 66 Fed. 810 (1895); *Buckwalter v. Whipple* 115 Ga. 484 (1902), (41 S. E. Rep. 1010).

directory of another company, a conveyance of all the assets of the one corporation to the other — these directors participating in the transaction — has been held to be *prima facie* fraudulent.<sup>1</sup> But the fact that both corporations have the

<sup>1</sup> Where the directors of an insolvent corporation ordered the conveyance of all its property to secure a debt due from it to another corporation, at a meeting in which several directors who voted for the resolution authorizing the conveyance were also directors of the corporation for whose benefit the conveyance was made, it was held that the conveyance so authorized was *prima facie* fraudulent as to creditors, and would be declared void, unless it was clearly shown that it was fair and reasonable, and absolutely free from fraud. *Sweeny v. Grape Sugar Refining Co.*, 30 W. Va. 443 (1887), (4 S. E. Rep. 431, 8 Am. St. Rep. 88).

In *Barrie v. United Rys. Co.* 125 Mo. App. 96 (1907), (102 S. W. Rep. 1078, 1082) the Court said: "For the reason that the directory and chief officers of both corporations are practically identical, the presumption is that the tripartite agreement, as between the two corporations, is fraudulent, and hence the assets acquired from the transit company by the United Railways Company, under said agreement, are held by the latter company in trust for the benefit of creditors of the former. But this presumption is not an irrebuttable legal presumption. It is a presumption of fact which may be overcome by clear and convincing proof that the officers and directors acted with impartiality and absolute fairness, so that no advantage was given one corporation over the other in the terms of or in the performance of the contract." — Citing this work.

The following extract from the opinion in *O'Connor Mining, etc. Co. v. Coosa Furnace Co.*, 95 Ala. 614,

618 (1891), (10 So. Rep. 290, 36 Am. St. Rep. 251), clearly states the relations of creditors to the internal affairs of corporations: "The directors of a corporation, in the transaction of its business and the disposition of its property, do not stand in any such relation to the general creditors of the corporation as they occupy to the corporation itself and to its stockholders. They are not the agents of such creditors nor can they usually be regarded as trustees acting in their behalf. The creditors are not entitled to disaffirm a transfer of the property of the corporation, made by its directors or other agents, merely because the corporation itself or its stockholders could have done so. When a disposition of the property of a corporation is assailed by its creditors, they are not clothed with the right of the corporation or of its stockholders to set aside the transaction, regardless of its fairness or unfairness, on the ground that it was entered into by representatives of the corporation who had put themselves in a relation antagonistic to the interests of their principal. The right of the creditor to impeach the transaction depends upon its fraudulent character. The question in such case is, was the transaction which is complained of entered into with the intent to hinder, delay or defraud creditors? Was the property fraudulently transferred or conveyed? The mere fact that the corporation, in disposing of its property, dealt with persons who at the same time were charged with the duty of representing its interests, does not, by itself, render the transaction fraudulent.

"Where the property of a corpora-

same officers and stockholders does not *necessarily* render a conveyance fraudulent as to creditors.<sup>1</sup>

§ 125. **Remedies of Creditors.** — There are several remedies open to creditors in the case of fraudulent conveyances by debtor corporations.

1. A creditor may subject the consideration for the sale, money, stocks, bonds or other property, when received by the vendor corporation — his debtor — to the payment of his debt in such manner, by execution sale or otherwise, as the statutes may permit.<sup>2</sup> This course may be taken in every case, without regard to the fraudulent character of the transaction, for corporate property is always liable to be taken for corporate debts.

2. A creditor, having established the validity of his claim at law,<sup>3</sup> may seek the aid of a court of equity to follow the cor-

tion is transferred to another corporation represented by the same directors, the fact of such relationship is a circumstance well calculated to arouse suspicion, and calls for a rigid and severe scrutiny in the examination of such transaction when it is assailed by a creditor. When such a relationship is shown to exist between the contracting parties, clearer and fuller proof of the good faith of the parties is necessary than would be required if the transferee or grantee had been a stranger. When, however, such examination is made, and such proof is forthcoming, and the result is that no fraud or unfair dealing is shown, and it appears that the transaction was not vitiated by any infirmity of which the creditor has the right to complain, then the transaction must stand, and it is as valid, as against the creditor, as if the corporation had dealt with a stranger, who was not involved in any way with the corporate representatives."

See also *Banks v. Judah*, 8 Conn. 145 (1830); *Levins v. Peoples Grocery Co.* (Tenn. 1896), 38 S. W. Rep. 733.

<sup>1</sup> *Cole v. Millerton Iron Co.*, 133

N. Y. 164 (1892), (30 N. E. Rep. 847, 28 Am. St. Rep. 615), *affirming* 59 Hun, 217 (1891), (13 N. Y. Supp. 851).

In *Warfield v. Marshall County Canning Co.*, 72 Iowa, 666 (1887), (34 N. W. Rep. 467, 2 Am. St. Rep. 263), it was held that a sale by a failing corporation of all its property to another corporation, which agreed to pay its obligations to the full value of the property sold, would not be set aside as fraudulent, because the stockholders of the first formed a part of stockholders of the second corporation, there being no fraudulent purpose shown.

See also *Barr v. Bartram, etc. Mfg. Co.*, 41 Conn. 506 (1874).

<sup>2</sup> Where the assets of a corporation were transferred to a new company, formed for the purpose of acquiring them, the consideration of the transfer being the issue of stock, the stock so issued to the old corporation cannot be appropriated by shareholders to the detriment of creditors, but it is liable for the corporate debts. *Vance v. McNabb Coal, etc. Co.*, 92 Tenn. 47 (1892), (20 S. W. Rep. 424).

<sup>3</sup> *Swan Land, etc. v. Frank*, 148

porate property into the hands of the purchaser and apply it, or its avails, in payment of his judgment debt.<sup>1</sup> A court of equity may grant this relief, or, it is said, may charge the purchaser with the value of the property, upon the ground already noticed that the assets of a corporation constitute in equity a fund for the payment of its debts, and cannot be diverted

U. S. 603 (1893), (13 Sup. Ct. Rep. 691), citing *Nat. Tube Works v. Ballou*, 146 U. S. 517 (1892), (13 Sup. Ct. Rep. 165); *Scott v. Neely*, 140 U. S. 106 (1891), (11 Sup. Ct. Rep. 712); *Taylor v. Bowker*, 111 U. S. 110 (1884), (4 Sup. Ct. Rep. 397). But see *Blanc v. Paymaster Min. Co.*, 95 Cal. 524 (1892), (30 Pac. Rep. 765, 29 Am. St. Rep. 149).

<sup>1</sup>In *Ewing v. Composite Brake Shoe Co.*, 169 Mass. 73 (1897), (47 N. E. Rep. 241), Judge Lathrop said: "It is obvious, however, that where a new corporation is formed, the creditors of the old corporation do not, without something further being done, become creditors of the new corporation. They have an equitable right to follow the assets of the old corporation; but they cannot maintain an action at law against the new corporation, for there is no privity of contract. To render the new corporation liable there must be a new contract made, such as will amount to a novation."

While a reorganized corporation may not be liable for the debts of the original corporation, the property acquired from it may be reached by its creditors in the hands of a reorganized corporation. *Marshall v. Western North Carolina R. Co.*, 92 N. C. 322 (1885).

In *Hurd v. New York, etc. Laundry Co.*, 167 N. Y. 89 (1901), (60 N. E. Rep. 327) the New York Court of Appeals, basing its decision upon the "trust fund doctrine," held that when the rights of creditors have intervened, a corporation has no right to convey its assets to another

corporation in consideration of the issue of stock of the latter to its stockholders; that the creditors of the vendor corporation had a right to rely upon those assets for the payment of their debts and had an equitable lien thereon.

In *Vicksburg, etc. Telephone Co. v. Citizens Telephone Co.* 79 Miss. 341 (1901), (30 So. Rep. 725, 89 Am. St. Rep. 656), where one corporation had transferred all its property to another without consideration passing to the vendor corporation which then ceased to do business, the Court, in holding that the property might be followed in equity, said (p. 354): "We think the same principle which applies in favor of the simple contract creditor against a consolidated corporation, enabling him to subject, in the hands of that consolidated company property of a constituent corporation received by the consolidated company (such constituent corporation being debtor of the simple contract creditor) will apply in cases like this."

See also *Schleider v. Dielman*, 44 La. Ann. 62 (1892), (10 So. Rep. 934); *Brum v. Merchants Ins. Co.*, 16 Fed. 140 (1883); *Hibernia Ins. Co. v. St. Louis, etc. Transp. Co.*, 10 Fed. 596 (1882), s. c. 13 Fed. 516 (1882); *First Nat. Bank v. Chattanooga, etc. Co.*, 97 Tenn. 308 (1896), (37 S. W. Rep. 8). Also *Montgomery, etc. R. Co. v. Branch*, 59 Ala. 139 (1877), considered in *Central R., etc. Co. v. Pettus*, 113 U. S. 116 (1885), (5 Sup. Ct. Rep. 387). And see *McWilliams v. City of New York*, 134 Fed. 1015 (1904); *Barber v. International, etc.*

therefrom and nothing left.<sup>1</sup> Judgment creditors may also be entitled to the aid of a receiver in following corporate assets.<sup>2</sup>

3. Upon the same principle, a creditor may charge stockholders who have received shares of stock or other property forming the consideration for a sale of corporate assets, as trustees for his benefit.<sup>3</sup> The property belongs in equity to

Co., 73 Conn. 587 (1901), (48 Atl. Rep. 758).

<sup>1</sup> Grenell v. Detroit Gas Co., 112 Mich. 73 (1897), (70 N. W. Rep. 413): "A corporation cannot sell all its property and take in payment stock in a new corporation under an arrangement that has the effect of distributing the assets of the vendor among its stockholders to the exclusion and prejudice of its creditors; and a company making such a purchase, in consideration of the issue of its own stock to such stockholders, takes the property subject to the rights of creditors. Such an arrangement is a diversion of the trust fund."

Where the majority stockholder of a corporation purchased a large amount of the remaining stock and arranged with the other stockholders that the assets of the corporation should be conveyed to a new corporation, the stock of which should be issued to the stockholders of the old corporation, it was held that the transaction amounted to an absorption of the old by the new corporation, and that the latter was responsible for the debts of the former, and would not be heard to say that the assets which it took over were of no value.

Camden Interstate R. Co. v. Lee, (Ky. 1905), 84 S. W. Rep. 332.

<sup>2</sup> Barclay v. Quicksilver Min. Co., 6 Lans. (N. Y.) 25 (1872), (9 Abb. Pr. N. s. 283). See also Alexander v. Relfe, 74 Mo. 495 (1881). Couse v. Columbia Powder Mfg. Co. (N. J. 1895), 33 Atl. Rep. 297.

<sup>3</sup> Where the assets of a corporation

are transferred to another company and the proceeds are divided among its stockholders, in proportion to the amount of their stock, they are *trustees for creditors* as to the amount received, the transaction being, in effect, a distribution of such assets by the company to its own stockholders.

Hill v. Gruell, 42 Ill. App. 411 (1891). See also Panhandle Nat. Bank v. Emery, 78 Tex. 498 (1890), (15 S. W. Rep. 23); McKusick v. Seymour, 48 Minn. 172 (1892), (50 N. W. Rep. 1116).

Where the stockholders of a corporation received from another corporation an agreed price per share for their stock and thereupon, without further consideration, conveyed the entire assets of their corporation to the corporation which had purchased their shares, it was held that the stockholders held the moneys paid them — constituting the consideration of the sale — as a trust fund for the payment of the debts of the vendor corporation. It was further held that the purchasing corporation had paid full value for the property received and was not responsible for such debts.

Hagemann v. Southern El. Co., 202 Mo. 249 (1907), (100 S. W. Rep. 1081).

But with respect to the last conclusion *compare* cases cited in notes to § 124, *ante*.

Where, upon a sale of the entire property of a corporation to another company for its bonds, an arrangement is made whereby the bonds are divided directly among its stock-

the corporation to be held for the benefit of its creditors. It constitutes the purchase price for the sale of the property and when stockholders divert it to themselves they appropriate corporate assets and are chargeable therefor.

4. A creditor may institute an action at law against his debtor — the vendor corporation — and, where attachments are permitted, may attach the corporate property so transferred as being still the property of his debtor, or may levy execution thereon after judgment.<sup>1</sup> This action is predicated upon the principle that a transfer in fraud of creditors is void as to them.

5. A creditor may hold the purchasing corporation directly responsible when, in taking over the property, it assumes the debts of the vendor.<sup>2</sup>

Laches may bar a creditor from seeking relief in equity.<sup>3</sup>

holders, such an arrangement is void as to the creditors, and the bonds belong to them. *Fort Payne Bank v. Alabama Sanitarium*, 103 Ala. 358 (1893), (15 So. Rep. 618); *Chattanooga, etc. R. Co. v. Evans*, 66 Fed. 809 (1895).

<sup>1</sup> The property of a corporation, transferred to a new corporation for its stock, may still be attached by the creditors of the old company. *McVicker v. American Opera Co.*, 40 Fed. 861 (1889).

A judgment creditor may levy upon and sell upon execution property so transferred.

*Montgomery Web Co. v. Dienelt*, 133 Pa. St. 585 (1890), (19 Atl. Rep. 428, 19 Am. St. Rep. 663). See also *Prentice v. United States, etc. Steamship Co.*, 78 Fed. 106 (1897); *Buckwalter v. Whipple*, 115 Ga. 484 (1902), (41 S. E. Rep. 1010).

<sup>2</sup> See *ante*, § 123: "*Liability of Purchasing Corporation for Debts of Vendor Company — Assumption of Obligations.*"

Where an insolvent corporation sold its property to another corporation for bonds of the purchasing corporation, one of the conditions of

the sale being a guaranty that all claims against the vendor corporation and its property should be discharged before the payment of the purchase price, it was held that such guaranty was personal to the purchasing corporation, and not enforceable for the benefit of the vendor corporation's creditors.

*Randall v. Detroit, etc. R. Co.*, 134 Mich. 493 (1903), (96 N. W. Rep. 567).

Where one corporation transfers all its property and assets to another company in consideration of stock of the latter being issued to the stockholders of the former, it is held that the latter corporation holds the property so received as trustee for the creditors of the old corporation, and may be compelled to account therefor.

*Wilson v. Æolian Co.*, 64 App. Div. (N. Y.) 337 (1901), (72 N. Y. Supp. 150).

<sup>3</sup> *Townsend v. St. Louis, etc. Mining Co.*, 159 U. S. 21 (1894), (15 Sup. Ct. Rep. 997); *Vaughn v. Comet, etc. Co.*, 21 Colo. 54 (1895), (39 Pac. Rep. 422).



Thus a delay of a year during which the purchasing corporation went on investing money with respect to the property conveyed, and incurring liabilities, has been held to debar a creditor from equitable relief.<sup>1</sup>

Creditors are only interested in sales of corporate property with respect to their several claims. Consequently, where an exchange of corporate property for stock in another corporation is approved by all the stockholders, a court, at the instance of a creditor, will only disturb the transfer so far as is necessary to satisfy the creditors' demand, leaving it otherwise in the condition in which the stockholders had a legal right to place it.<sup>2</sup>

§ 126. **Priority of Purchaser's Mortgage over Claims of Vendor's Creditors.** — Upon the principle that the assets of a corporation are a trust fund for the payment of its debts, it is sometimes said that creditors have an equitable lien thereon which they may enforce against transferees. But, as already shown, the expression can be so used only in a figurative sense. Creditors have no lien before judgment, and after judgment only when given by statute. They may follow property into the hands of a purchaser when transferred, actually or constructively, in fraud of their rights, because, in such a case, equity will disregard forms and treat the property as being held by the purchasing company for their benefit. So equity will disregard or set aside a mortgage made by the purchaser of the property so acquired where the mortgagee takes with knowledge of the whole transaction.<sup>3</sup>

Where, however, the purchaser mortgages the property for

<sup>1</sup> *Hamilton v. Menominee Falls Quarry Co.*, 106 Wis. 352 (1900), (81 N. W. Rep. 876). See also *Anthony v. Campbell*, 112 Fed. 212 (1901).

<sup>2</sup> *Wilson v. Æolian Co.*, 64 App. Div. (N. Y.) 337 (1901), (72 N. Y. Supp. 150), *affirmed* 170 N. Y. 618 (1902), (63 N. E. Rep. 1123).

<sup>3</sup> Where a transfer by a corporation to another company, with the same stockholders, of all its property was without consideration, except the assumption of debts, and the transferee immediately executed a

mortgage to secure an issue of bonds, covering its own property and that thus acquired, it was held that the mortgage should be set aside, at least as to bondholders who did not stand as *bona fide* purchasers. *Cole v. Millerton Iron Co.*, 133 N. Y. 164 (1892), (30 N. E. Rep. 847, 28 Am. St. Rep. 615).

Where a sale is set aside as *ultra vires* a mortgage by the vendee is void. *Knoxville v. Knoxville, etc. R. Co.*, 22 Fed. 758 (1884).

a present consideration and the mortgagee acts in good faith, the mortgage takes precedence of claims of creditors who have not acquired a statutory lien, by judgment or attachment, prior to its execution.<sup>1</sup> This conclusion is not inequitable. It merely gives the same priority to a *bona fide* mortgage made by a purchaser that such a mortgage would have had if made by the debtor, the selling corporation. Questions as to following the avails of a mortgage do not affect its validity.

Notice of the existence of a creditor's claim does not, standing alone, alter the position of a mortgagee.<sup>2</sup> Knowledge of the fraudulent character of the transfer, as well as of the claim, must be shown.

#### IV. Sales of Property of Quasi-public Corporations.

##### § 127. Indispensable Property cannot be alienated or taken on Execution without Statutory Authority. — Private cor-

<sup>1</sup> In *Fogg v. Blair*, 133 U. S. 538 (1890), (10 Sup. Ct. Rep. 338), Justice Field said: "The property of a railroad company is not held under any such trust to apply it to the payment of its debts as to restrict its use for any other lawful purpose, it matters not how meritorious the demand of the creditor may be. He must obtain a lien upon the property of the company, or security in some other form, or he will have to take his chances with all other creditors to obtain payment in the ordinary course of legal proceedings for the collection of debts."

See also *Lebeck v. Fort Payne Bank*, 115 Ala. 447 (1897), (22 So. Rep. 75, 67 Am. St. Rep. 51).

<sup>2</sup> In *Fogg v. Blair*, *supra*, Justice Field also said (p. 540): "There is no evidence in the record before us that the parties who took the bonds issued by the St. Louis, Hannibal and Keokuk Railroad Co. had any notice, actual or constructive, of the demand of the complainant. But if they had, it would not have affected their rights. That demand was not then reduced to judgment

and created no lien upon the property of the company, nor any restriction upon the companies' right to use it for any lawful purpose. The bonds were given to raise the necessary funds to complete the road of the company and the mortgage was executed to secure their payment. They were negotiable instruments, and, in the hands of the purchasers, cannot be impeached for any neglect of the company issuing them to pay the demands of other creditors. We are unable to perceive any ground upon which their priority over the claim of the appellant can be, in any way, impaired. We do not question the general doctrine, invoked by the appellant, that the property of a railroad company is a trust fund for the payment of its debts, but do not perceive any place for its application here."

Compare this opinion with those of the circuit judges in the same case *sub nom.* *Blair v. St. Louis, etc. R. Co.*, 27 Fed. 176 (1886) (Brewer, J.), 25 Fed. 684 (1885) (Brewer, J.), 24 Fed. 148 (1885) (Treat, J.), and 22 Fed. 36 (1884) (Treat, J.).

porations, owing no public duties, have power, as already shown, to sell all their property.<sup>1</sup> Limitations, for the protection of creditors and minority stockholders, may be placed upon the exercise of the power, but its existence as between the corporation and the State is unquestionable.

*Quasi-public corporations* — railroad, canal, telegraph, gas and other public utility companies — stand in an essentially different position. These companies enjoy franchises granted by the State, in consideration of the assumption of obligations to the public. As a corollary to the conclusion elsewhere shown to be established that corporate franchises cannot be transferred without authority from the State, it follows that corporate property necessary for the performance of public duties or, as sometimes stated, essential to the exercise of corporate franchises, cannot be sold or disposed of without such authority.<sup>2</sup> Upon the same principle, it also follows that such essential property is not subject to sale on execution, unless the levy is authorized by statute.<sup>3</sup> The underlying

<sup>1</sup> *Ante*, § 108: "Power to purchase and sell Generally."

<sup>2</sup> *United States*: Central Transp. Co. v. Pullman Car Co., 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); York, etc. R. Co. v. Winans, 17 How. (U. S.) 30 (1854). See also *Briscoe v. Southern*, etc. R. Co., 40 Fed. 280 (1889).

In *Cumberland Telephone*, etc. Co. v. City of Evansville 127 Fed. 194 (1903) the Court said: "The Evansville Telephone Exchange was authorized and empowered to establish and maintain its telephone system, not to sell it; to accomplish the object of its incorporation, not to defeat it; to acquire the means to enable it to perform its duties to the public as a corporation, not to disable itself from performing those duties. The attempted sale of all its property and franchises was *ultra vires*, and contrary to public policy, and, therefore, null and void."

*Georgia*: Singleton v. Southwestern R. Co., 70 Ga. 464 (1883), (48 Am. Rep. 574).

*New Hampshire*: Richards v. Merrimack, etc. R. Co., 44 N. H. 127 (1862).

*New Jersey*: Black v. Delaware, etc. Canal Co., 22 N. J. Eq. 399 (1871).

*Pennsylvania*: Foster v. Fowler, 60 Pa. St. 27 (1868).

*Texas*: Missouri Pac. R. Co. v. Owens, 1 Tex. Civ. Cas. App. § 385 (1883); Gulf, etc. R. Co. v. Morris, 67 Tex. 692 (1887), (4 S. W. Rep. 156). See also cases cited in the following note which illustrate the same principle.

<sup>3</sup> *United States*: East Alabama R. Co. v. Doe, 114 U. S. 340, (1885), (5 Sup. Ct. Rep. 869); Gue v. Tide Water Canal Co., 24 How. 257 (1860).

*Indiana*: Louisville, etc. R. Co. v. Boney, 117 Ind. 501 (1888), (20 N. E. Rep. 432, 3 L. R. A. 435); Indianapolis R. Co. v. State, 105 Ind. 37 (1885), (4 N. E. Rep. 316).

*Kentucky*: Louisville Water Co. v. Hamilton, 81 Ky. 517 (1883).

*North Carolina*: State v. Rives, 5 Ired. 297 (1844).

principle is that property, necessary to enable a corporation to fulfil its obligations to the State, is impressed with a trust in favor of the public.<sup>1</sup>

But this underlying principle is inapplicable to a sale by a *quasi*-public corporation of all its property to a municipal corporation, for municipal service, provided the latter have authority to purchase. The trust in favor of the public is not broken by a transfer to the public.<sup>2</sup>

§ 128. **Test of Indispensability.** — In applying the rule that the property of a *quasi*-public corporation, necessary for the performance of its public duties, cannot, in the absence of statutory authority, be alienated or taken on execution, the courts have sometimes drawn the line of indispensability between the real and the personal property of the corporation — holding that the latter can, and that the former cannot, be sold or taken. Thus, in *Coe v. Columbus, etc. R. Co.*<sup>3</sup> the

*Ohio*: *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 372 (1859), (75 Am. Dec. 518).

*Pennsylvania*: *Youngman v. Elmira, etc. R. Co.*, 65 Pa. St. 278, 286 (1870); *Western Pennsylvania R. Co. v. Johnston*, 59 Pa. St. 290 (1869); *Plymouth R. Co. v. Colwell*, 39 Pa. St. 337 (1861); *Ammant v. New Alexandria Turnpike Co.*, 13 Serg. & R. 210 (1825), (15 Am. Dec. 593); *Leedam v. Plymouth R. Co.*, 5 W. & S. 265 (1843).

*Tennessee*: *Baxter v. Nashville, etc. Turnpike Co.*, 10 Lea, 488 (1882).

*Texas*: *City of Palestine v. Barnes*, 50 Tex. 538 (1878).

<sup>1</sup> 2 Morawetz Priv. Corp. § 1125.

<sup>2</sup> *City of Indianapolis v. Consumers' Gas Trust Co.*, 144 Fed. 643 (1906): "In none of the citations, State or general, are there any reasons stated that seem inconsistent with the proposition that a corporation, engaged in a service of public utility, may contract for a sale to the municipality of all the property therein, either through a condition accepted in the franchise from the city, or through subsequent arrange-

ment. The question whether municipal ownership is favorable to the public interest, is neither involved in, nor open to, judicial inquiry. Assuming that such ownership is authorized, and is contemplated or demanded by the municipality, we are convinced that this proviso, treated alone as a contract of sale on the part of the gas company, is not within the inhibition of the rule — not *ultra vires*. The public policy which is mentioned in the cases cited, as opposed to an implication of charter power to turn over its property to another and 'abnegate the performance of its duties to the public,' has no application to the transfer to the public — the municipality — of property used in public service."

A statute authorizing a city to purchase a water or lighting plant authorizes as well the corporation owning such plant to sell, although it is thereby rendered unable to perform its public duties.

*Connor v. City of Marshfield*, 128 Wis. 280 (1906), (107 N. W. Rep. 639).

<sup>3</sup> *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 379 (1859), (75 Am. Dec.

Supreme Court of Ohio said: "The line can be clearly drawn between the interest in real estate and the franchise connected therewith, and the movable things employed in the use of the franchise." Upon this principle, it has been held that the road-bed and fixtures of a railroad company,<sup>1</sup> the road of a turnpike company,<sup>2</sup> the canal and locks of a canal company<sup>3</sup> and the plant of a water company<sup>4</sup> cannot be seized upon execution; while, on the other hand, it has been held that the rolling stock of a railroad<sup>5</sup> and the ferry boat of a ferry company<sup>6</sup> can be taken.

This test of indispensability is illogical. The rolling stock of a railroad is as essential to its use and operation as the road-bed, and neither is more necessary than the other. The foundation of the rule being the indispensability of the property, the assumption that real estate is more necessary than personal property begs the question. The true test should be whether the property, real or personal, is necessary, in a reasonable sense, for the performance of the public duties of the corporation.<sup>7</sup> This subject is, however, at the present time, a matter of statutory regulation in nearly all the States.

§ 129. **Sales of Surplus Property.** — Indispensable property, in the absence of statutory authority, cannot be sold. Conversely, surplus property — property which is not indispens-

518). *Compare*, however, *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478).

<sup>1</sup> *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 372 (1859), (75 Am. Dec. 518); *Youngman v. Elmira, etc. R. Co.*, 65 Pa. St. 278, 286 (1870); *Western, etc. R. Co. v. Johnstown*, 59 Pa. St. 290 (1869); *Leedam v. Plymouth R. Co.*, 5 W. & S. (Pa.) 265 (1843).

A portion of a railroad which has been abandoned is subject to levy of execution. *Benedict v. Heineberg*, 43 Vt. 231 (1870).

<sup>2</sup> *Ammant v. New Alexandria Turnpike Co.*, 13 Serg. & R. 210 (1825), (15 Am. Dec. 593); *Baxter v. Nashville, etc. Turnpike Co.*, 10 Lea (Tenn.), 488 (1882).

<sup>3</sup> *Gue v. Tide Water Canal Co.*, 24 How. (U. S.) 257 (1860); *Susquehanna Canal Co. v. Bonham*, 9 W. & S. (Pa.) 27 (1845).

<sup>4</sup> *Louisville Water Co. v. Hamilton*, 81 Ky. 517 (1883).

<sup>5</sup> *Louisville, etc. R. Co. v. Boney*, 117 Ind. 501 (1888), (20 N. E. Rep. 432, 3 L. R. A. 435); *Boston, etc. R. Co. v. Gilmore*, 37 N. H. 410 (1858), (72 Am. Dec. 336); *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 372 (1859), (75 Am. Dec. 518).

<sup>6</sup> *Lathrop v. Middleton*, 23 Cal. 257 (1863), (83 Am. Dec. 112).

<sup>7</sup> See an able and comprehensive note to *Brunswick, etc. Co. v. United States Gas Co.*, 35 Am. St. Rep. 390. Also *Short's Railway Bonds & Mortgages*, p. 165.

able—in the absence of statutory prohibition, may be sold. A *quasi*-public corporation is vested with full *jus disponendi* over all its property, real and personal, which is not necessary to enable it to carry on the business for which it was chartered or to fulfil its public obligations.<sup>1</sup>

In *Hendee v. Pinkerton*,<sup>2</sup> Judge Foster said: “We entertain no doubt that the . . . Company could lawfully sell and convey the lands embraced in this bill. They were not acquired to enable the corporation to carry on the business which it was chartered to do for the benefit of the public, nor needed or used for that purpose. Their alienation in no wise impaired or affected the usefulness of the company as a railroad, or its ability to exercise any of its corporate franchises. In the absence of any express or implied legislative prohibition, this corporation possessed all the ordinary rights of ownership over these lands, and could convey them away absolutely or mortgage them to secure any valid indebtedness.”

§ 129a. **Ultra vires Sales of Property of Private and Quasi-Public Corporations.** — The question of the want of power of corporations to enter into intercorporate relations has generally arisen in the case of railroad leases, in the examination of which the underlying principles are fully considered.<sup>3</sup> It is, therefore

<sup>1</sup> *Branch v. Jesup*, 106 U. S. 468 (1882), (1 Sup. Ct. Rep. 495).

Town lots, held by a railroad company, do not pass by a sale of a railroad “with its corporate privileges and appurtenances” unless directly appurtenant to the railroad and indispensably necessary to the enjoyment of its franchises. *Shamokin Valley R. Co. v. Livermore*, 47 Pa. St. 465 (1864), (86 Am. Dec. 552). Compare *Platt v. Union Pacific R. Co.*, 99 U. S. 48 (1878).

See also *Yates v. Van De Bogert*, 56 N. Y. 530 (1874): “The company acquired title in fee under that deed. When the land was no longer necessary for the purposes of the corporation it had a right to sell and convey the same.”

The rule that the property of a *quasi*-public corporation reasonably

essential to the exercise of its franchises cannot be sold is inapplicable to property which has not become a part of the corporation's structure and for which it has no immediate use.

*Johnson Co. v. Miller*, 174 Pa. St. 605 (1896), (34 Atl. Rep. 316, 52 Am. St. Rep. 833).

In this case steel rails not required for construction work were levied upon by creditors of a railway company.

Where a railroad company sells a terminal switch to the owner of the land upon which it is laid, it violates no public duty. *Oman v. Bedford-Bowling Green Stone Co.* 134 Fed. 64 (1905).

<sup>2</sup> *Hendee v. Pinkerton*, 14 Allen (Mass.), 386 (1867).

<sup>3</sup> See *post*, Ch. XXII: “*Ultra vires and Voidable Railroad Leases.*”

only necessary here to apply those principles to the subject of corporate sales.

These propositions may be regarded as established:

(1) An *ultra vires* contract unexecuted by either party is void, and affords no right of action at law for damages, nor in equity for specific performance.

(2) An *ultra vires* contract executed on both sides cannot be questioned in the courts, and the parties will be left in the possession of money or property acquired thereunder.

It follows then that an *ultra vires* contract of sale while executory is wholly unenforceable.<sup>1</sup> But when the contract has

<sup>1</sup> *Alabama*: *Simmons v. Troy Iron Works*, 92 Ala. 427 (1890), (9 So. Rep. 160); *Long v. Georgia Pacific R. Co.* 91 Ala. 519 (1890), (8 So. Rep. 706, 24 Am. St. Rep. 931).

*Michigan*: *Day v. Spiral Springs Buggy Co.*, 57 Mich. 146 (1885), (23 N. W. Rep. 628, 58 Am. Rep. 352).

*Mississippi*: *Greenville Compress, etc. Co. v. Planters Compress, etc. Co.*, 70 Miss. 669 (1893) (13 So. Rep. 879, 35 Am. St. Rep. 681).

*Missouri*: *Hoagland v. Hannibal, etc. R. Co.* 39 Mo. 451 (1867).

*New Hampshire*: *Downing v. Mt. Washington R. Co.*, 40 N. H. 234 (1860): "The power of buying and selling real and personal property for the legitimate purposes of the corporation, and the power of contracting generally for the same purposes, within the limits prescribed by the charter, being granted, we understand the principle to be, that their purchases, sales, and contracts generally, will be presumed to be made within the legitimate scope and purpose of the corporation, until the contrary appears, and that the burden of showing that any contract of a corporation is beyond its legitimate powers, rests on the party who objects to it. If a corporation attempt to enforce a contract made with them in a case beyond the legitimate limits of their corporate power, that fact being shown, will ordinarily

constitute a perfect defence. And if a suit is brought upon a contract alleged to be made by the corporation, but which is shown to be beyond its corporate power to enter into, the contract will be regarded as void, and the corporation may avail themselves of that defence."

*New York*: *Nassau Bank v. Jones*, 95 N. Y. 123 (1884), (47 Am. Rep. 14): "While executed contracts made by corporations in excess of their legal powers have, in some cases, been upheld by the courts and the parties have been precluded from setting up as a defence to actions brought by corporations their want of power to enter into such contracts, this doctrine has never been applied to a mere executory contract, which is sought to be made the foundation of an action either for or against such corporation."

*Ohio*: *Coppin v. Greenles, etc. Co.* 38 Ohio St. 275 (1882), (43 Am. Rep. 425).

*Wisconsin*: *Northwestern Union Packet Co. v. Shaw*, 37 Wis. 655 (1875), (19 Am. Rep. 781).

*England*: *Ashbury Railway Carriage, etc. Co. v. Riche*, L. R. 7 H. L. 653. In this case it was also held that an *ultra vires* contract made by directors could not be ratified by the stockholders — that the ratification was as void as the contract.

been executed by the conveyance of the corporate property and the payment of the purchase price, the title vests in the purchaser and the corporation cannot disaffirm and recover back the property.<sup>1</sup> And, conversely, a conveyance to a corporation of property beyond its power to acquire, but for which it has fully paid the price, passes the title to the corporation and it can hold the property and sell it and give good title. Only the State, in direct proceedings, can question the validity of the transaction.<sup>2</sup>

But while the decisions are uniform with respect to *ultra vires* contracts which have been executed by both parties and by neither party, they are widely at variance regarding such contracts when executed upon one side only. Thus, where a

<sup>1</sup> The question whether a corporation in selling its property acted *ultra vires* will not be considered when it has received the purchase price. Especially is this true when the purchaser has mortgaged the property.

City of Spokane v. Amsterdamsch Trustees Kantoor, 22 Wash. 172 (1900), (60 Pac. Rep. 141).

When an *ultra vires* contract of sale has been executed by the delivery of the deed and full payment of the purchase money, a court of equity will not annul the sale or grant other relief.

Long v. Georgia Pacific R. Co., 91 Ala. 519 (1890), (8 So. Rep. 706, 24 Am. St. Rep. 931).

See also Lancaster v. Amsterdam Impt. Co., 140 N. Y. 576 (1894), (35 N. E. Rep. 967); Mallett v. Simpson, 94 N. C. 37 (1886), (55 Am. Rep. 594). And see cases cited in next note.

<sup>2</sup> Rogers v. Nashville etc. R. Co., 91 Fed. 317 (1898): "If the contract was *in fieri*, it might be open to a stockholder upon a bill properly framed to restrain his company's officers from completing such an alleged transaction. But that is not this case. This is an executed transaction. The title has vested.

Until the State shall institute

proceedings for the forfeiture of the charter or for the purpose of defeating the title, it is a sound legal title."

See also:

United States: Blair v. City of Chicago, 201 U. S. 400 (1906), (26 Sup. Ct. Rep. 427).

Alabama: South and North Alabama R. Co. v. Highland Ave., etc. R. Co., 119 Ala. 105 (1898), (24 So. Rep. 114); Long v. Georgia Pacific R. Co., 91 Ala. 519, 522 (1890), (8 So. Rep. 706, 24 Am. St. Rep. 931).

Illinois: Hamsher v. Hamsher, 132 Ill. 273 (1890), (23 N. E. Rep. 1123, 8 L. R. A. 556); Hough v. Cook County Land Co., 73 Ill. 23 (1874).

Massachusetts: Nantasket Beach S. S. Co. v. Shea, 182 Mass. 147 (1902), (65 N. E. Rep. 57).

New York: Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co., 127 N. Y. 252 (1891), (27 N. E. Rep. 831, 24 Am. St. Rep. 448).

North Carolina: Mallett v. Simpson, 94 N. C. 37 (1886), (55 Am. Rep. 594).

Ohio: Walsh v. Barton, 24 Ohio St. 28 (1873).

Virginia: Fayette Land Co. v. Louisville, etc. R. Co. 93 Va. 274 (1896), (24 S. E. Rep. 1016).



corporation acting beyond its powers has received a conveyance of property without paying the price, or has conveyed its property without receiving the consideration, justice manifestly requires that relief in some form should be granted. The theory upon which relief should be granted and its form present the difficult questions.

Upon the one hand, it is said that as the corporation is incapable of making the contract and it is wholly void, execution upon one side cannot give it validity, and that the corporation cannot be estopped from pleading its want of power because all persons dealing with it are bound to know the limitations of its charter. Consequently, it is held that no action can be maintained upon the void contract, and that the party who has performed can only obtain relief by disaffirming the sale and suing to recover back the price paid or the property or its value.<sup>1</sup>

On the other hand, many courts hold that where a contract is merely *ultra vires* and not otherwise illegal, the corporation is estopped to set up the defence of *ultra vires* to a suit for the recovery of the agreed price, and that such defence cannot be pleaded against it.<sup>2</sup> This conclusion while just is illogical. It makes the measure of the power of a corporation, not its charter, but that which it attempts to do.

The strict doctrine that an *ultra vires* contract of sale is abso-

<sup>1</sup> See extract from decision of the Supreme Court of the United States in *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 59 (1891), (11 Sup. Ct. Rep. 478) printed in note to § 239, *post*: "*Distinction between Ultra Vires and Irregular Leases.*"

See also *post*, § 241: "*Delivery of Possession under Ultra Vires Lease*"; *post*, § 242: "*Right and Duty of Disaffirmance*"; *post*, § 423: "*Recovery of Property after Disaffirmance.*"

The strict doctrine stated in the text is also that of the English courts and those of Alabama, Maine, Ohio, Tennessee, and several other States. For cases of sales see *Northwestern Union Packet Co. v. Shaw*, 37 Wis.

655 (1875), (19 Am. Rep. 781); *Chewaca Lime Works v. Dismukes*, 87 Ala. 344 (1889), (6 So. Rep. 122, 5 L. R. A. 100).

<sup>2</sup> See cases cited in notes to § 244, *post*.

The New York Court of Appeals has led in stating the more liberal doctrine. It has been followed by the courts of New Jersey, Michigan, Pennsylvania, and other States. For cases of sales see *Dewey v. Toledo*, etc. R. Co., 91 Mich. 351 (1892), (51 N. W. Rep. 1063); *Wright v. Pipe Line Co.*, 101 Pa. St. 204 (1882), (47 Am. Rep. 701); *Whitney Arms Co. v. Barlow*, 63 N. Y. 62 (1875), (20 Am. Rep. 504).

lutely unenforceable is undoubtedly applicable in the case of sales by *quasi*-public corporations because these sales are not only beyond the power of the corporation but are contrary to public policy. In the case of strictly private corporations, however, it is believed that the weight of authority at the present time supports the more liberal doctrine. In a recent case<sup>1</sup> the Supreme Court of the United States quoted as "intrinsically sound" the following language of the New York Court of Appeals<sup>2</sup>: "It is now well settled that a corporation cannot avail itself of the defence of *ultra vires* when the contract has been in good faith fully performed by the other party and the corporation has had the benefit of the performance and of the contract. As has been said, corporations, like natural persons, have power and capacity to do wrong. They may in their contracts and dealings break over the restraints imposed upon them by their charters; and when they do so their exemption from liability cannot be claimed upon the mere ground that they have no attributes nor faculties which render it possible for them thus to act. While they have no right to violate their charters, yet they have capacity to do so, and are bound by their acts where a repudiation of them would result in manifest wrong to innocent parties, and especially where the offender alleges its own wrong to avoid a just responsibility. It may be that while a contract remains unexecuted upon both sides, a corporation is not estopped to say in its defence that it had not the power to make the contract sought to be enforced, yet when it becomes executed by the other party, it is estopped from asserting its own wrong and cannot be excused from payment upon the plea that the contract was beyond its power."

<sup>1</sup> *Eastern Building, etc. Ass'n v. Williamson*, 189 U. S. 122, 129 (1902), (23 Sup. Ct. Rep. 527). While the Supreme Court, in this case, was considering the law of New York upon the subject, its reference to the language quoted as "intrinsically

sound" would indicate that it approved the doctrine stated, although it is not in line with some of its own earlier decisions.

<sup>2</sup> *Vought v. Eastern Building, etc. Ass'n*, 172 N. Y. 508 (1902), (65 N. E. Rep. 496, 92 Am. St. Rep. 761).

## CHAPTER XII

## SALES OF CORPORATE FRANCHISES

I. *Transferability of Franchises*

- § 130. Nature of a Franchise.
- § 131. Franchise of Corporate Existence.
- § 132. Transferability of Franchise of Corporate Existence.
- § 133. Franchises of Corporations.
- § 134. Transferability of Franchises of Corporations.

II. *Legislative Authority for Sale of Franchises*

- § 135. Legislative Authority essential to Alienation of Franchises.
- § 136. Unauthorized Sale of Franchises — *Ultra vires*.
- § 137. Unauthorized Sale of Franchises — Against Public Policy.
- § 138. Unauthorized Sale of Franchises — Unlawful Delegation of Powers.
- § 139. Legislative Authority essential to Purchase of Franchises.
- § 139 a. *Ultra Vires* Sales of Franchises.

I. *Transferability of Franchises*

§ 130. **Nature of a Franchise.** — In *Bank of Augusta v. Earle*<sup>1</sup> Chief Justice Taney defined franchises as “special privileges conferred by government upon individuals and which do not belong to citizens of the country generally, of common right.”<sup>2</sup> This definition is unexceptionable. The essential prerequisites to the existence of a franchise are, therefore :

<sup>1</sup> *Bank of Augusta v. Earle*, 13 Pet. (U. S.) 595 (1839).

<sup>2</sup> *Fietsam v. Hay*, 122 Ill. 294 (1887), (13 N. E. Rep. 501, 3 Am. St. Rep. 493): “The word *franchise* is often used in the sense of privileges generally, but in its more appropriate and legal sense the term is confined to such rights and privileges as are conferred upon corporate bodies by legislative grant.”

*St. Louis, etc. R. Co. v. Balsley*, 18 Ill. App. 82 (1885): “Franchises are rights and privileges acquired only by special grant from the public through the legislature, which impose upon the

grantee, as the consideration therefor, a duty to the public to see that they are properly used.”

Chancellor Kent says that “franchises are privileges conferred by grants from the government and vested in private individuals.”<sup>3</sup> *Kent's Com.* 458. See also *Bouvier's, Law Dict. “Franchise.”* Chicago, etc. *R. Co. v. Dunbar*, 95 Ill. 571 (1880), (1 Am. & Eng. R. Cas. 214). Franchises are “branches of the king's prerogative, subsisting in a subject by grant from the crown.”<sup>3</sup> *Cruise Dig.* 278.

1. A grant from the sovereign authority: for there can be no franchise which is not derived from a law of the State.<sup>1</sup>

2. A special privilege: for that which belongs to citizens generally can never be a franchise.<sup>2</sup>

3. A right conferred upon private individuals (or corporations): for privileges granted to public bodies are not franchises.<sup>3</sup>

Franchises relating to corporations are of two kinds:<sup>4</sup>

1. The franchise to be a corporation, conferred upon the corporators.

2. The franchises of the corporation, conferred upon the corporation.

§ 131. **Franchise of Corporate Existence.** — The legislature in granting a special charter of incorporation confers upon the persons named therein — the corporators — the privilege of forming and being a corporation. This privilege may be termed the franchise of corporate existence.<sup>5</sup> It is true that the State,

<sup>1</sup> *Woods v. Lawrence County*, 1 Black (U. S.), 409 (1861): "A franchise is a privilege conferred, in the United States, by the immediate or antecedent legislation of an act of incorporation, with conditions expressed, or necessarily inferential from its language, as to the manner of its existence and for its enjoyment."

*Bank of Augusta v. Earle*, 13 Pet. U. S. 595 (1839): "It is essential to the character of a franchise that it should be a grant from the sovereign authority, and in this country no franchise can be held which is not derived from a law of the State." See also *Wilmington Water Power Co. v. Evans*, 166 Ill. 556 (1897), (46 N. E. Rep. 1083).

<sup>2</sup> In *California v. Central Pac. R. Co.*, 127 U. S. 40 (1888), (8 Sup. Ct. Rep. 1073), it was said: "Generalized, and divested of the special form which it assumes under a monarchical government based on feudal traditions, a franchise is a right, privilege, or power of public concern, which ought not to be exercised by private

individuals at their mere will and pleasure, but should be reserved for public control and administration, either by the government directly, or by public agents acting under such conditions and regulations as the government may impose in the public interest and for the public security."

See also *Abbott v. Omaha Smelting, etc. Co.*, 4 Neb. 420 (1876); *Bridgeport v. New York, etc. R. Co.*, 36 Conn. 255 (1869).

<sup>3</sup> 3 Kent's Com. 458.

<sup>4</sup> In *Fietsam v. Hay*, 122 Ill. 293 (1887), (13 N. E. Rep. 501, 3 Am. St. Rep. 493), the word "franchise" was said to include "the right or privilege of being a corporation, and of doing such things, and such things only, as are authorized by the corporation's charter."

<sup>5</sup> *Paul v. Virginia*, 8 Wall. (U. S.) 168 (1868). See also *State v. Western Irrigating Canal Co.*, 40 Kan. 99 (1888), (19 Pac. Rep. 349, 10 Am. St. Rep. 166), where the Supreme Court of Kansas, following 2 Morawetz Priv. Corp. § 923, said: "The word 'fran-

in enacting general incorporation laws, confers a similar privilege upon those who comply with the provisions of such laws, but this privilege can hardly be termed a franchise. It is not a *special* privilege.

The franchise to be a corporation belongs to the stockholders and not to the corporation. The grantees of the charter are, primarily, the incorporators, and the franchise is vested in them, their associates and successors. The corporation when formed may itself take, under the charter, special rights and privileges — also termed franchises — necessary to carry into effect the objects for which it was formed, but the franchise to be a corporation remains in the stockholders.<sup>1</sup> “A corporation is itself a franchise belonging to the members of the corporation: and a corporation being itself a franchise may hold other franchises, as rights and franchises of the corporation.”<sup>2</sup> Mr.

chise’ is generally used to designate a right, or privilege, conferred by law. What is called the franchise of forming a corporation is really but an exemption from the general rule of the common law prohibiting the formation of corporations. All persons in this State have now the right of forming corporate associations upon complying with the simple formalities prescribed by the statute. The right of forming a corporation and of acting in a corporate capacity, under the general incorporation laws, can be called a franchise only in the sense in which the right of forming a limited partnership, or of executing a conveyance of land by deed, is a franchise.”

In *Young v. Webster City, etc. R. Co.*, 75 Iowa, 143 (1888), (39 N. W. Rep. 234), it was said: “The corporation itself is not a franchise but it is the attributes of the corporation which comprise the franchises thereof, — its special powers and rights.” Compare *Knoup v. Piqua Branch of State Bank*, 1 Ohio St. 614 (1853).

<sup>1</sup> *Fietsam v. Hay*, 122 Ill. 293 (1887), (13 N. E. Rep. 501, 3 Am. St. Rep. 449): “A franchise or the right

to be and act as an artificial body is vested in the individuals who compose the corporation and not in the corporation itself.”

In *Central Trust Co. v. Western North Carolina R. Co.*, 89 Fed. 24 (1898), Judge Simonton said: “This new person, creature of the law, and existing through the grace of and at the will of the sovereign, was then clothed with certain powers, and granted certain privileges. These are its franchises. First, the franchise of existence as a corporation, — its life and its being. This is inseparable from it. When it parts with this franchise, it parts with its life. But, with respect to the other franchises with which it has been clothed, — the right and privilege to act as a common carrier, to carry passengers and goods, to charge tolls, to operate a railroad, — these it enjoys as an individual could, and they are not inseparable from its existence. They are its property. A franchise to be a corporation is distinct from a franchise, as a corporation, to maintain and operate a railroad.”

<sup>2</sup> *Pierce v. Emery*, 32 N. H. 507 (1856).

Justice Matthews, in *Memphis, etc. R. Co. v. Commissioners*,<sup>1</sup> pointed out the distinction between the franchise to be a corporation and the franchises of the corporation: "The essential properties of corporate existence are quite distinct from the franchises of the corporation. The franchise of being a corporation belongs to the corporators, while the powers and privileges, vested in and to be exercised by the corporate body, as such, are the franchises of the corporation."<sup>2</sup>

§ 132. **Transferability of Franchise of Corporate Existence.** — As the franchise of corporate existence belongs to the stockholders of a corporation, they may, practically, transfer it by the sale of their shares of stock; and, in a sense, the sale of a single share amounts *pro tanto* to a transfer of an interest in this primary franchise. The purchasers, however, merely become stockholders in the same corporation in place of the vendors — the corporate identity remains unchanged.

The franchise to be a corporation, as a franchise, in its nature is incommunicable by act of the parties.<sup>3</sup> Neither the corpo-

<sup>1</sup> *Memphis, etc. R. Co. v. Commissioners*, 112 U. S. 619 (1884), (5 Sup. Ct. Rep. 299). See also *New Orleans, etc. R. Co. v. Delamore*, 114 U. S. 501 (1885), (5 Sup. Ct. Rep. 1009).

<sup>2</sup> *Wright v. Milwaukee, etc. R. Co.*, 25 Wis. 53 (1869): "The distinction between the franchise of constructing and operating a railroad, and the franchise of being a corporation, and of contracting, suing and being sued as such, is well established."

The franchise to be a corporation is not, strictly, a corporate franchise at all. *Meyer v. Johnston*, 53 Ala. 237 (1875).

For consideration of the distinction between the franchise of corporate existence and the franchises of the corporation see *State v. East Fifth St. R. Co.*, 140 Mo. 539 (1897), (41 S. W. Rep. 955, 62 Am. St. Rep. 742, 38 L. R. A. 218).

<sup>3</sup> *Memphis, etc. R. Co. v. Commissioners*, 112 U. S. 619 (1884), (5 Sup. Ct. Rep. 299): "The franchise of becoming and being a corporation, in its

nature, is incommunicable by the act of the parties and incapable of passing by assignment."

*Commonwealth v. Smith*, 10 Allen (Mass.), 455 (1865), (87 Am. Dec. 672) *per Hoar, J.* "The franchise to be a corporation clearly cannot be transferred by any corporate body, of its own will. Such a franchise is not, in its own nature, transmissible."

A corporation cannot "sell or convey its corporate name, or its right to maintain and defend judicial proceedings or to make and use a common seal." *State v. Western Irrigating Canal Co.*, 40 Kan. 96 (1888), (19 Pac. Rep. 349, 10 Am. St. Rep. 166).

See also *New Orleans, etc. R. Co. v. Delamore*, 114 U. S. 501 (1885), (5 Sup. Ct. Rep. 1009); *Welsh v. Old Dominion Mining, etc. Co.*, 56 Hun (N. Y.), 650 (1890), (10 N. Y. Supp. 174); *Ragan v. Aiken*, 9 Lea (Tenn.), 609 (1882), (42 Am. Rep. 684, 9 Am. & Eng. R. Cas. 201); *Atkinson v. Marietta, etc. R. Co.*, 17 Ohio St. 21 (1864).

ration nor the stockholders can usurp the functions of the legislature and confer upon others the privilege of forming a corporation. As said by Mr. Justice Curtis, at circuit, in *Hall v. Sullivan R. Co.*:<sup>1</sup> "The franchise to be a corporation is, therefore, not a subject of sale and transfer, unless the law, by some positive provision, has made it so, and pointed out the modes in which such sale and transfer may be effected."

Even where a positive statutory provision appears authorizing a corporation to transfer its charter or franchise to be a corporation, the real transaction is in no sense a sale or conveyance. The so-called transferee takes nothing from the deed of transfer and everything from the legislative grant of power. The act of the incorporators or stockholders in transferring — in form — their corporate franchise, in legal effect is a surrender of their charter. The legislative authorization amounts to a grant of a new charter — in similar terms — to the transferees, taking effect upon the abandonment of the old. "The vital part of the transaction, and that without which it would be a nullity, is the *law* under which the transfer is made."<sup>2</sup>

§ 133. **Franchises of Corporations.** — The legislature, in conferring a charter of incorporation upon persons about to engage in an enterprise involving the assumption of obligations to the public, generally grants such special rights as may be necessary to enable the corporation, so created, to carry into effect the objects of its creation. These special privileges constitute the franchises of the corporation.<sup>3</sup> Thus, in years

<sup>1</sup> Compare *Miller v. Rutland, etc. R. Co.*, 36 Vt. 452 (1863); *Bank of Middlebury v. Edgerton*, 30 Vt. 182 (1858); *Shapley v. Atlantic, etc. R. Co.*, 55 Me. 395 (1868).

<sup>2</sup> *Hall v. Sullivan R. Co.*, 21 Law Rep. 138 (1857), (1 Brunner Coll. Cas. 613, 11 Fed. Cas. 257).

<sup>3</sup> *State v. Sherman*, 22 Ohio St. 428 (1872), approved in *Memphis, etc. R. Co. v. Commissioners*, 112 U. S. 609, 619 (1884), (5 Sup. Ct. Rep. 299). Compare *Abbott v. New York, etc. R. Co.*, 145 Mass. 453 (1888), (15 N. E. Rep. 91).

<sup>3</sup> In *Society for Savings v. Coite*, 6 Wall. (U. S.) 606 (1867). Mr. Justice Clifford said: "Corporate franchises are legal estates vested in the corporation itself as soon as it is *in esse*. They are not mere naked powers granted to the corporation, but powers coupled with an interest, which vest in the corporation upon the possession of its franchises, and whatever may be thought of the incorporators, it cannot be denied that the corporation itself has a legal interest in such franchises."

A franchise of a corporation may

past, legislatures have granted to innumerable corporations franchises to build bridges, construct turnpike roads, dig and operate canals, maintain ferries, and collect tolls thereon;<sup>1</sup> and, in the present, franchises are granted in constantly increasing numbers for the occupancy of the public streets and highways by the various public utility corporations.<sup>2</sup>

A railroad company is also an example — the most conspicuous — of a corporation exercising corporate franchises. "The franchises of a railroad corporation," said Mr. Justice Field in *Morgan v. Louisiana*,<sup>3</sup> "are rights or privileges which are essential to the operations of the corporation, and without which its roads and works would be of little value; such as

be defined as a right of a corporation to exercise powers and privileges vested in it by its charter. *Spring Valley Water Works v. Schottler*, 62 Cal. 69 (1882).

<sup>1</sup> That the right to collect tolls upon bridges, turnpike roads, etc., is a franchise, see *Turnpike Road Co. v. Campbell*, 44 Cal. 89 (1872); *Blake v. Winona, etc. R. Co.*, 19 Minn. 418 (1872), (18 Am. Rep. 345); *Sellers v. Union Lumbering Co.*, 39 Wis. 525 (1876).

<sup>2</sup> That the right to lay gas pipes in the streets of a city is a franchise derivable from the State, see *New Orleans Gas Light Co. v. Louisiana Light, etc. Co.*, 115 U. S. 650 (1885), (6 Sup. Ct. Rep. 252); *Jersey City Gas Co. v. Dwight*, 29 N. J. Eq. 242 (1878); *State v. Cincinnati Gas Light, etc. Co.*, 18 Ohio St. 262 (1868). See also *Chicago Mun. Gas Light Co. v. Lake*, 130 Ill. 42 (1889), (22 N. E. Rep. 616). Compare, however, *State v. Mut. Gas Light Co.*, 38 Mich. 154 (1878); *Commonwealth v. Lowell Gas Light Co.*, 12 Allen (Mass.), 75 (1866).

The right to lay water-pipes and collect water-rates is a franchise. *Spring Valley Water Works v. Schottler*, 62 Cal. 69 (1882); *State v. Portage City Water Co.*, 107 Wis. 441 (1900), (83 N. W. Rep. 697).

The right to occupy city streets with wires and appliances for the transmission of electricity for telephone or electric light service is a franchise.

*Cumberland Telephone, etc. Co. v. City of Evansville*, 127 Fed. 186 (1903); *Purnell v. McLane*, 98 Md. 589 (1903), (56 Atl. Rep. 543). Compare *Commercial Electric Light, etc. Co. v. City of Tacoma*, 17 Wash. 661 (1897), (50 Pac. Rep. 592).

It seems that corporations organized to furnish heat to buildings, through pipes laid in city streets, are not quasi-public corporations to the extent that they are subject to the general principles of law applicable to that class of corporations in the disposition of their privileges and property. *Evans v. Boston Heating Co.*, 157 Mass. 37 (1892), (31 N. E. Rep. 698). See also as to irrigating companies, *State v. Western Irrigating Canal Co.*, 40 Kan. 96 (1888), (19 Pac. Rep. 349, 10 Am. St. Rep. 166).

<sup>3</sup> *Morgan v. Louisiana*, 93 U. S. 223 (1876). See also *Lawrence v. Morgan's, etc. Steamship Co.*, 39 La. Ann. 427 (1887), (2 So. Rep. 69, 4 Am. St. Rep. 265), where railroad companies were said to have the right to appropriate land for several purposes other than those stated in *Morgan v. Louisiana*, *supra*.



the franchise to run cars, to take tolls, to appropriate earth and gravel for the bed of its road, or water for its engines, and the like."

The franchise of a railroad company may also be defined as the right, by virtue of the power of eminent domain, to construct, maintain, and operate a railroad upon the route designated in its charter, and to take tolls for the transportation of persons and property thereon.<sup>1</sup>

The franchise of a street railway or other public utility-corporation to occupy the streets of a city must proceed primarily from the sovereign power — the State. If the legislature authorize municipal corporations to grant the privilege, it is held in a series of decisions that the effect of the legislation is to confer the *franchise* upon the municipality which may issue a *license*, or make a *contract*, for its exercise. These decisions are based upon the theory that there can be no delegation of the power to grant franchises — a part of the power to make laws. On the other hand it is held, upon the more convincing reasoning, that the State may grant a franchise acting through the agency of a municipal corporation — that whether granted directly or indirectly the right emanates from the same source, the sovereign power.<sup>2</sup> "An act done by the

<sup>1</sup> *Colt v. Barnes*, 64 Ala. 108 (1879); *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 372 (1859), (75 Am. Dec. 518).

<sup>2</sup> *Delegation of power to grant franchises.*

(a) The right to construct and operate a street railway in a city and to take tolls from persons traveling thereon, is a franchise which the sovereign power alone can grant.

*People's Pass. R. Co. v. Memphis City R. Co.*, 10 Wall (U. S.) 38 (1869). *Denver etc. R. Co. v. Denver City R. Co.* 2 Colo. 673 (1875); *State v. Jacksonville R. Co.*, 29 Fla. 590 (1892), (10 So. Rep. 590); *Metropolitan City R. Co. v. Chicago West Division R. Co.* 87 Ill. 317 (1877); *Chicago City R. Co. v. People*, 73 Ill. 541 (1874); *State v. East Fifth St. R. Co.*, 140 Mo. 539 (1897), (41 S. W. Rep. 955, 62 Am. St. Rep. 742, 38

L. R. A. 218); *Lincoln St. R. Co. v. City of Lincoln*, 61 Neb. 109 (1901), (84 N. W. Rep. 802); *Milhau v. Sharp*, 27 N. Y. 611 (1863), (84 Am. Dec. 314); *Davis v. New York*, 14 N. Y. 506 (1856), (67 Am. Dec. 186); *People v. Kerr*, 37 Barb. 357 (1862); *Wright v. Milwaukee Electric R. Co.*, 95 Wis. 29 (1897), (69 N. W. 791, 60 Am. St. Rep. 74, 36 L. R. A. 47).

For cases holding that rights conferred upon corporations to occupy city streets with gas and water-pipes, and telephone and electric light wires, conduits and appliances are franchises derivable from the State alone, see preceding notes to this section.

(b) In *People's Pass. R. Co. v. Memphis City R. Co.* 10 Wall. (U. S.) 38 (1869), the Supreme Court said: "Power to make laws is vested in the legislature under the constitution

State through its duly authorized agent is an act done by the State itself.”<sup>1</sup> Where, however, the right granted by the municipality amounts to a valid contract, as distinguished from a revocable license, the distinction, if any, between it and a franchise is of little practical importance.

A franchise of a corporation is to be distinguished from a privilege — in the nature of an exemption — granted to its members or employees. The grant of the former constitutes

of the State, and it is very doubtful whether the legislative department can delegate to any body or authority the power to grant such a franchise, as the exercise of that power involves a high trust created and conferred for the benefit of those who granted it, and as the trust is confided to the legislature it must remain where it is vested until the constitution of the State is changed.”

Following this decision it has been held in several important cases that where municipalities are authorized to grant to public service corporations the right to occupy their streets, the right so granted is a license, or if irrevocable a contract, and not a franchise.

*Metropolitan City R. Co. v. Chicago West Division R. Co.*, 87 Ill. 317 (1877); *Chicago City R. Co. v. People*, 73 Ill. 541 (1874); *Cain v. City of Wyoming*, 104 Ill. App. 538 (1902); *Lincoln St. R. Co. v. City of Lincoln*, 61 Neb. 109 (1901), (84 N. W. Rep. 802); *Denver City, etc. R. Co. v. Denver City R. Co.*, 2 Colo. 673 (1875). See also *Lasher v. People*, 183 Ill. 226, 233 (1899), (55 N. E. Rep. 663, 75 Am. St. Rep. 103, 47 L. R. A. 802); *State v. Jacksonville R. Co.*, 29 Fla. 590 (1892), (10 So. Rep. 590).

(c) Notwithstanding the intimation in *People's Pass. R. Co. v. Memphis City R. Co.*, *supra*, that the State could not delegate its power to grant franchises, the Supreme Court in a later case (*New Orleans Gas Co. v.*

*Louisiana Light Co.*, 115 U. S., 659 (1885), (6 Sup. Ct. Rep. 252)), said: “The right to dig up the streets and other public ways and place therein pipes and mains for the distribution of gas for public and private use is a franchise, the privilege of exercising which could only be granted by the State or by the municipal government of that city acting under legislative authority.”

In line with this decision are a series of cases holding that a franchise may be granted to a public utility corporation through the instrumentality of a municipality — that such a privilege though passing indirectly to the corporation is still strictly a legislative grant.

*State v. East Fifth St. R. Co.*, 140 Mo. 539 (1897), (41 S. W. Rep. 955, 62 Am. St. Rep. 742, 38 L. R. A. 218); *Purnell v. McLane*, 98 Md. 589 (1903), (56 Atl. Rep. 830); *Wright v. Milwaukee Electric R., etc. Co.*, 95 Wis. 29 (1897), (69 N. W. Rep. 791, 60 Am. St. Rep. 74, 36 L. R. A. 47); *State v. Portage City Water Co.*, 107 Wis. 441 (1900), (83 N. W. Rep. 697); *Port of Mobile v. Louisville, etc. R. Co.*, 84 Ala. 115 (1887), (4 So. Rep. 106, 5 Am. St. Rep. 342); *Turnpike Road Co. v. Campbell*, 44 Cal. 89 (1872). See also *Cumberland Telephone, etc. Co. v. City of Evansville*, 127 Fed. 187 (1903).

<sup>1</sup> *Port of Mobile v. Louisville, etc. R. Co.*, 84 Ala. 115 (1887), (4 So. Rep. 106, 5 Am. St. Rep. 342).

a contract with the State within the protection of the constitutional provision, while the latter may be revoked at any time.<sup>1</sup>

The grant of a franchise, unless expressly so stated, is not a contract on the part of the State that it will grant no similar franchises to other corporations. That charters do not confer *exclusive* privileges, unless so expressed, was definitely settled by the Supreme Court of the United States in the celebrated Charles River Bridge case.<sup>2</sup>

The franchises of a corporation are also to be distinguished from its powers. The former are special privileges; the latter are rights possessed by natural persons generally, and are acquired by a corporation in order to transact business.<sup>3</sup>

<sup>1</sup> It is the better view that statutes exempting employees of corporations from militia duty, jury duty, road duty, etc., confer personal privileges upon the employees and may be repealed by the legislature at any time without regard to the existence of a reserved power to repeal. *Neeley v. State*, 4 Lea (Tenn.), 316 (1880). The contrary is, however, held in *Johnson v. State*, 88 Ala. 176 (1889), (7 So. Rep. 253).

<sup>2</sup> *Charles River Bridge v. Warren Bridge*, 11 Pet. (U. S.) 420 (1837). See also *Thompson v. New York*, etc. R. Co., 3 Sandf. Ch. (N. Y.) 62 (1846). Compare *New Jersey Southern R. Co. v. Long Branch Commrs.*, 39 N. J. L. 28 (1876).

That the franchises of a corporation may be taken by the exercise of the power of eminent domain, see *West River Bridge Co. v. Dix*, 6 How. (U. S.) 507 (1848).

<sup>3</sup> *State v. Minnesota Thresher Mfg. Co.*, 40 Minn. 213 (1889), (41 N. W. Rep. 1020, 3 L. R. A. 510), where the Court said: "The kinds of business which corporations organized either under title 2, c. 34 (of Gen. Stat. 1878), or under the Act of 1873, are authorized to carry on, are powers, but not franchises, because it is a right possessed by all

citizens who choose to engage in it, without any legislative grant. The only franchise which such corporations possess is the general franchise to be or exist as a corporate entity. Hence, if they engage in any business not authorized by the statute, it is *ultra vires*, or in excess of their powers, but not a usurpation of franchises not granted, nor necessarily a misuser of those granted."

For discussion of the distinction between the *property* of a corporation and its franchises, see *Tuckahoe Canal Co. v. Tuckahoe*, etc. R. Co., 11 Leigh (Va.), 42 (1840), (36 Am. Dec. 374); *Bridgeport v. New York*, etc. R. Co., 36 Conn. 255 (1869), (4 Am. Rep. 63); *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543 (1869), (99 Am. Dec. 300).

Where a corporation proposed to purchase all the real estate and assets, including the franchises, of another corporation and this proposition was accepted by a vote of the stockholders of the latter who authorized the directors to carry out the arrangement, and a deed of the real estate and appurtenances was delivered and the purchaser was put into possession of all the property, it was held that there was a valid transfer of the franchises.

§ 134. **Transferability of Franchises of Corporations.** — Conversely to the proposition, considered in another section, that a transfer of corporate franchises without legislative authority is void,<sup>1</sup> it follows that such a transfer with such authority is valid. When the State which grants the franchises of a corporation consents to their alienation, they become communicable, in whole or in part, in accordance with the consent so given.<sup>2</sup>

While franchises are generally considered to be incorporeal hereditaments and, therefore, property,<sup>3</sup> it seems, upon principle, that corporate franchises cannot pass directly from vendor to purchaser in the manner of corporate property. A franchise, in its essence, is a privilege conferred by grant to

*City of Kalamazoo v. Power Co.*, 124 Mich. 74 (1900), (82 N. W. Rep. 811).

A deed purporting to convey the property and franchises of a corporation may be valid as to the former although invalid as to the latter.

*Klosterman v. Mason County, etc.* R. Co., 8 Wash. 281, 286 (1894), (36 Pac. Rep. 136); *Gloninger v. Pittsburgh, etc. R. Co.*, 139 Pa. St. 13 (1890), (21 Atl. Rep. 211).

<sup>1</sup> See next section.

<sup>2</sup> *East Boston, etc. R. Co. v. Eastern R. Co.*, 13 Allen (Mass.), 422 (1866), *per* Wells, J.: "The doctrine that a railroad corporation cannot alienate its franchise is not founded upon any technical theory nor arbitrary rule, but upon the reasonable implication that such alienation would be contrary to the intention of the legislature and subversive of the purpose for which the franchise was granted. The same considerations apply, only perhaps with greater force, to the subdivision of the franchise by the transfer of a part. . . . But an alienation of the franchise, either in whole or in part, may, undoubtedly be made, whenever there is legislative authority for it, either in express terms or by reasonable implication."

See also *Vermont, etc. R. Co. v. Vermont Central R. Co.*, 34 Vt. 1 (1861); *Day v. Ogdensburg, etc. R. Co.*, 107 N. Y. 129 (1887), (13 N. E. Rep. 765).

In *Matter of Long Acre Electric Light, etc. Co.*, 51 Misc. (N. Y.) 407 (1906), (101 N. Y. Supp. 460), *affirmed* 188 N. Y. 361 (1907), (80 N. E. Rep. 1101) it was held that special franchises are transferable as property independently of the life of the corporation to which they were originally granted.

<sup>3</sup> In *Enfield Toll Bridge Co. v. Hartford, etc. R. Co.*, 17 Conn. 60 (1845), (42 Am. Dec. 716), Chief Justice Williams said in reference to a bridge franchise: "What are the rights of the plaintiffs? They are derived from the grant of the legislature, and are what in law is known to be a *franchise*; and a franchise is an incorporeal hereditament, known as a species of property, as well as any estate in lands. It is property, which may be bought and sold, which will descend to heirs, and may be devised."

See also *Hall v. Sullivan R. Co.*, 21 Law Rep. 138 (1857), (1 Brunner Coll. Cas. 613, 11 Fed. Cas. 257). These cases are merely indicative of a long line of decisions.

exercise extraordinary powers. A corporation cannot transfer this right any more than a person can transfer an office which he holds; but in the same manner that the office-holder, when authorized, might appoint another to hold the office, the corporation by the form of sale may delegate to another corporation the right to exercise the special privileges conferred upon it.<sup>1</sup>

This principle is somewhat analogous to the principle, already considered, that the "transfer" of a charter in reality means its surrender and the grant anew of a similar charter to the "transferee."<sup>2</sup> But there is this fundamental distinction: The exercise of a power of appointment in relation to the franchises of a corporation confers upon the appointee the *same* franchises, while the grant of a new charter confers *similar* franchises. This distinction is of importance where constitutional restrictions have intervened between the grant of the old and the grant of the new charter.

## II. Legislative Authority for Sale of Franchises

§ 135. **Legislative Authority essential to Alienation of Franchises.** — It is a rule applicable to all corporations exercising public franchises that such franchises can be transferred only by and with the consent of the State which granted them — that corporate franchises are incommunicable without legislative authority.

The courts have assigned various reasons for the existence of the rule,<sup>3</sup> of which the following are based upon principles fundamentally sound:

<sup>1</sup> Compare 2 Morawetz Priv. Corp. § 924.

The words "transfer," "sale" and "lease" are, upon the principles stated in the text, technically incorrect when used in connection with corporate franchises. They are, however, in general use and express the idea of the passing of franchises — absolutely or for limited terms — from one corporation to another with sufficient accuracy. They will, therefore, be employed in this treatise

in order to avoid a cumbersome form of expression.

<sup>2</sup> Ante, § 132: "*Transferability of Franchise of Corporate Existence.*"

<sup>3</sup> It has sometimes been said, as an additional reason to those stated in the text, that a franchise is deemed a *personal trust* and, therefore, that the State has the right to determine who shall be the recipients of it. But as pointed out in an editorial note to Brunswick Gas Light Co. v. United Gas, etc. Co., 35 Am St. Rep. 393

1. The charter of a corporation is the measure of its powers. Unless authority to transfer its franchises is expressly granted, such an act is *ultra vires*.

2. The transfer by a corporation of its franchises — disabling it from the performance of its public duties — is *against public policy*.

3. A corporation exercising public franchises is an agent of the State and, without the consent of the State, cannot *delegate its powers*.

§ 136. **Unauthorized Sale of Franchises — Ultra Vires.** — The power to sell its franchises is not to be implied from the usual grant of powers to a *quasi*-public corporation but must be expressly conferred. Any exercise of the power without the sanction of the legislature is *ultra vires*.<sup>1</sup> The principle has thus been stated by the Supreme Court of Pennsylvania: "A corporation, unless specially restricted by its charter or some

(1893): "The theory of a personal confidence reposed in the original incorporators rests on a purely arbitrary foundation, . . . and the legislation which has in most, if not all, the States of the Union provided for a free transfer of franchises, as the result of the mortgage thereof, and even for the incorporation of the entirely uncertain body of persons who may purchase at the foreclosure sale, shows very conclusively that, in the opinion of the people of this country, the grounds of public policy upon which this restriction of the power of transfer is to be sustained must be sought in other directions."

Transfers of franchises have also, under certain conditions, been held illegal as tending to create monopolies. See Part V., *post*: "*Combinations of Corporations*."

<sup>1</sup> *United States*: *Branch v. Jesup*, 106 U. S. 468 (1882), (1 Sup. Ct. Rep. 495); *Cumberland Telephone, etc. Co. v. City of Evansville*, 127 Fed. 186 (1903); *Mackintosh v. Flint, etc. R. Co.*, 34 Fed. 582 (1888).

*Maryland*: *State v. Consolidation Coal Co.*, 46 Md. 1 (1876).

*Nebraska*: *Clarke v. Omaha, etc. R. Co.*, 4 Neb. 458 (1876).

*New York*: *Troy, etc. R. Co. v. Boston, etc. R. Co.*, 86 N. Y. 107 (1881).

*Ohio*: *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 372 (1859), (75 Am. Dec. 518).

*Pennsylvania*: *Pittsburgh, etc. R. Co. v. Bedford R. Co.*, 81½ Pa. St. 104 (1871).

*Texas*: *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690).

The general rule that *any* transfer of corporate franchises, without legislative authority, is *ultra vires* is supported by numerous decisions. Those especially relating to *sales* of franchises are cited in the above note and are further considered in § 143, *post*: "*Statutory Authority essential to Sale of Railroad*." Cases illustrating the same principle as applied to *leases of railroads* are collected in note to § 177, *post*; as applied to a transfer through *consolidation*, in § 17, *ante*; as applied to *mortgages* of franchises in note to § 149, "*Short's Railway Bonds and Mortgages*."

statute has general power to dispose of its property, the whole or part, but it has no right to sell or assign its franchises, either in whole or in part, unless specially authorized by law.”<sup>1</sup>

§ 137. **Unauthorized Sale of Franchises — Against Public Policy.** — Franchises are conferred upon corporations to enable them to provide facilities of benefit to the public. The consideration for the grant is the discharge by the corporation of its public duties; and public policy forbids a corporation, without legislative authority, to sell its franchises to another corporation and thus render itself incapable of performing those duties.<sup>2</sup> Mr. Justice Campbell, in *York, etc. R. Co.*

<sup>1</sup> *Pittsburgh, etc. R. Co. v. Bedford R. Co.*, 81½ Pa. St. 104 (1871). The extract quoted is subject to the criticism that it ignores the principle that the property of a quasi-public corporation — so far as it is indispensable — cannot be disposed of.

<sup>2</sup> *United States: York, etc. R. Co. v. Winans*, 17 How. (U. S.) 30 (1854); *Cumberland Telephone, etc. Co. v. City of Evansville*, 127 Fed. 187 (1903).

*Georgia: Georgia R. etc. Co. v. Haas*, 127 Ga. 187 (1906), (56 S. E. Rep. 313); *Singleton v. Southwestern R. Co.*, 70 Ga. 464 (1883).

*Massachusetts: Richardson v. Sibley*, 11 Allen, 65 (1865), (87 Am. Dec. 700).

*Illinois: Peoria, etc. R. Co. v. Coal Valley R. Co.*, 68 Ill. 489 (1873); *Hays v. Illinois, etc. R. Co.*, 61 Ill. 422 (1871).

*Nebraska: Cholette v. Omaha, etc. R. Co.*, 26 Neb. 159 (1889), (41 N. W. Rep. 1106, 4 L. R. A. 135).

*New Hampshire: Pierce v. Emery*, 32 N. H. 484 (1856).

*Ohio: Railroad Co. v. Hinsdale*, 45 Ohio St. 556 (1888), (15 N. E. Rep. 665).

*Tennessee: Frazier v. Railway Co.*, 88 Tenn. 138 (1889), (12 S. W. Rep. 537).

*Texas: East Line, etc. R. Co. v. Rushing*, 69 Tex. 306 (1887), (6 S. W.

Rep. 834); *Gulf, etc. R. Co. v. Morris*, 67 Tex. 692 (1887), (4 S. W. Rep. 156).

*Virginia: Naglee v. Alexandria, etc. R. Co.*, 83 Va. 707 (1887), (3 S. E. Rep. 369, 5 Am. St. Rep. 308).

See also *ante*, § 18: “*Consolidation of Quasi-public Corporations without Legislative Authority against Public Policy*”; *post*, § 143: “*Statutory Authority essential to Sale of Railroad*”; *post*, § 177: “*Lease of Railroad invalid without Legislative Authority*.”

In *Threadgill v. Pumphrey*, 87 Tex. 573 (1895), (30 S. W. Rep. 356), however, the Court said with respect to corporations organized under general laws, although engaged in the performance of quasi-public functions: “There is no personal trust involved in the grant of corporate powers under a general law of incorporation which authorizes all the citizens of the State to create a corporation for any one of certain specified objects, by merely filing articles of incorporation with the Secretary of State; and we do not see why the public interests may not be as well subserved by the purchasers of the property of the corporation as by the corporation itself, when it becomes confessedly unable or unwilling to pay its debts.”

For other cases apparently contrary to the rule that especial

v. *Winans*,<sup>1</sup> thus stated the reason of the rule: "Important franchises were conferred upon the corporation to enable it to provide facilities for communication and intercourse required for the public convenience. Corporate management and control over these were prescribed, and corporate responsibility for their insufficiency provided, as a remuneration to the community for their grant. The corporation cannot absolve itself from the performance of its obligations without the consent of the legislature."<sup>2</sup>

§ 138. **Unauthorized Sale of Franchises — Unlawful Delegation of Powers.** — A grant of franchises by the State constitutes the grantee, in a sense, an agent of the State in their exercise, and, upon an elementary principle of the law of agency, *delegatus non delegare*, the corporation — the agent — cannot sell its franchises to another corporation without the consent of the State — the principal. It is immaterial that the intending purchaser agrees to fulfil all the public obligations of the grantee.<sup>3</sup> The State has the right to select the persons who shall enjoy the franchises it grants, as well as those who shall fulfil the obligations due it.

While this reason for the doctrine that there is no implied power to transfer franchises is sound in principle, and has often been stated by the English courts, it is generally given as an additional reason to that of *ultra vires* or the rule of public policy, already considered. Thus, in *Winch v. Birkenhead, etc. R. Co.*,<sup>4</sup> Vice-Chancellor Parker, while referring to an

legislative authority is essential to the alienation of franchises see *State v. Topeka Water Co.*, 61 Kan. 547 (1900), (60 Pac. Rep. 337); *Michigan Telephone Co. v. City of St. Joseph*, 121 Mich. 502 (1899), (80 N. W. Rep. 383, 80 Am. St. Rep. 520, 47 L. R. A. 87). See also *Matter of Long Acre Electric Light, etc. Co.*, 188 N. Y. 361 (1907), (80 N. E. Rep. 1101).

<sup>1</sup> *York, etc. R. Co. v. Winans*, 17 How. (U. S.) 30 (1854).

<sup>2</sup> But the rule that a *quasi*-public corporation cannot, without the consent of the legislature, convey away its franchises and thus absolve itself from its obligations to the public, is

inapplicable where the transfer is to the public, i.e. to the municipal corporation for public service.

*City of Indianapolis v. Consumers' Gas Trust Co.*, 144 Fed. 640 (1906).

<sup>3</sup> *Troy v. Rutland R. Co.*, 17 Barb. (N. Y.) 581 (1854); *Beman v. Rufford*, 1 Sim. (N. s.) 569 (1851); *Winch v. Birkenhead, etc. R. Co.*, 5 De Gex & S. 562 (1852), (13 Eng. L. & Eq. 506); *Great Northern R. Co. v. Eastern Counties R. Co.*, 9 Hare, 306 (1851), (12 Eng. L. & Eq. Rep. 224).

<sup>4</sup> *Winch v. Birkenhead, etc. R. Co.*, 5 De Gex & S. 562 (1852), (13 Eng. L. & Eq. 506).



agreement for "working a line" as a delegation of powers, also said that the agreement was that the company should "part with certain statutory powers which they have no authority to part with, and moreover, that they were to part with them to a body who, by their constitution, cannot accept them."

The rule that a corporation has no implied power to delegate its franchises is essentially different from the rule that it has no power to delegate the performance of its public duties, although both produce the same result. A corporation, upon principles of the law of agency, cannot delegate its powers and franchises. A corporation, as a party to a contract with the State, cannot, for reasons of public policy, transfer its franchises to others and absolve itself from its obligations to the public assumed in consideration of their grant.

§ 139. **Legislative Authority essential to Purchase of Franchises.** — The same principles of law which forbid a corporation parting with its franchises, without the consent of the State which granted them, prevent a corporation, without legislative authority, from acquiring franchises granted to another corporation.<sup>1</sup> A corporation has no implied power to purchase corporate franchises and its acceptance of a conveyance of franchises, without authority, would be *ultra vires*.

It is essential to the validity of a contract transferring franchises that both parties should be expressly authorized to enter into it. As said by the Supreme Court of the United States in *Louisville, etc. R. Co. v. Kentucky*:<sup>2</sup> "It is a fundamental

<sup>1</sup> *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 691 (1896), (16 Sup. Ct. Rep. 714); *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953); *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); *Pittsburgh, etc. R. Co. v. Keokuk, etc. Bridge Co.*, 131 U. S. 371 (1889), (9 Sup. Ct. Rep. 770); *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409); *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 310 (1886), (6 Sup. Ct. Rep. 1094); *Camden, etc. R. Co. v. May's Landing R. Co.*, 48 N. J. L. 530 (1886), (7 Atl. Rep. 523);

*Gulf, etc. R. Co. v. Morris*, 67 Tex. 692 (1887), (4 S. W. Rep. 156). See also *Rogers v. Nashville, etc. R. Co.*, 91 Fed. 299 (1898).

It has, however, been held that authority given to one corporation to purchase the franchises of a specified corporation gives the latter authority to sell. *New York, etc. R. Co. v. New York, etc. R. Co.*, 52 Conn. 274 (1884).

<sup>2</sup> *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 692 (1896), (16 Sup. Ct. Rep. 714). See also *post*, § 144: "*Seller must have Authority to sell, and Buyer to buy.*"

principle in the law of contracts that, to make a valid agreement, there must be a meeting of minds, and, obviously, if there be a disability on the part of either party to enter into the proposed contract there can be no valid agreement." So upon principles of public policy, one corporation, unless permitted by the State, cannot assume and attempt to perform the duties imposed upon another corporation.

"A corporation having no authority under its own charter to acquire and exercise the rights, powers and franchises of another corporation, or to carry on the business of such other corporation, does not succeed to such rights, powers, and franchises by purchasing the property of the other company, though it be the whole of such property employed by that company in carrying on the business it was chartered to engage in."<sup>1</sup>

It has been held that a sale of the special franchises of an insolvent corporation by its receiver to an individual vests in the purchaser all the rights conferred by the original grant, and that a subsequent sale thereof to another individual has the same effect.<sup>2</sup> It would seem, however, upon principle, that the franchises in question — the right to operate electrical conductors in the streets of a city — involved the performance of public duties beyond the powers of an individual.<sup>3</sup>

<sup>1</sup> *Southern R. Co. v. Mitchell*, 139 Ala. 629 (1904), (37 So. Rep. 85).

<sup>2</sup> *Matter of Long Acre Electric Light, etc. Co.*, 188 N. Y. 361 (1907), (80 N. E. Rep. 1101). In this case the Court said (p. 366): "It seems to me to be very clear that the transfer to Minturn under his purchase at the receiver's sale vested him with all the rights conferred by the original franchise. It cannot be disputed that a franchise to operate electrical conductors in the streets is property, taxable, alienable, subject to levy and sale under execution and to condemnation under the exercise of the power of eminent domain. . . ." (p. 368) "There can be no doubt that in some of the text-books, as well as in some of the adjudged cases,

expressions may be found which would seem to support the broad doctrine that such a transfer by a corporation to an individual is absolutely void and of no more force than if it had never been made. But whatever may have been the law originally on this question, such a doctrine has long been practically ignored in this State. The text-books also recognize the fact that the drift of authority has been in the direction of sanctioning transfers such as were made in this case. Many of the cases where the courts have recognized and sanctioned such transfers do not appear to have been based on any special statute authorizing it."

<sup>3</sup> See *Stewart's Appeal*, 56 Pa. St. 413 (1867).

§ 139a. **Ultra Vires Sales of Franchises.**—The legal principles governing attempted *ultra vires* transfers of franchises by sale, the effect of their execution, and the rights and duties of the parties, are similar to those governing such transfers by lease and are elsewhere fully considered.<sup>1</sup>

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## ARTICLE II

### SALES OF RAILROADS

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## CHAPTER XIII

### CONTRACT OF SALE AND ITS EXECUTION

#### I. *Nature of Sale of Railroad*

- § 140. Conventional and Judicial Sales of Railroads distinguished.
- § 141. Distinction between Relation of Vendor and Vendee and Other Inter-corporate Relations.
- § 142. Distinction between Sale of Railroad and Sale of Franchises.

#### II. *Grants of Power to sell and purchase Railroads*

- § 143. Statutory Authority essential to Sale of Railroad.
- § 144. Seller must have Authority to sell and Buyer to buy.
- § 145. What Railroads may be the Subject of Sale. Statutory Provisions.
- § 146. Construction of Statutes.
- § 147. Constitutional and Statutory Prohibitions of Purchase of Competing or Parallel Lines.

#### III. *Authorization and Execution of Contract of Sale*

- § 148. Statutory Requisites.
- § 149. Assent of Stockholders. Whether Approval of Majority is sufficient.
- § 150. Acquiescence of Stockholders.
- § 151. Rights and Remedies of Dissenting Stockholders.

<sup>1</sup> See *post*, ch. XXII, "*Ultra vires and Voidable Railroad Leases.*" See also *ante*, § 129a: "*Ultra vires Sales of Property of Quasi-public and Private Corporations.*" This distinction between sales and leases must, however, be borne in mind: Sales are

executed by the delivery of the conveyance and payment of the purchase price. Leases are continuing contracts both as to rent and occupancy and are executory in respect of future performance.

I. *Nature of Sale of Railroad*

§ 140. **Conventional and Judicial Sales of Railroads distinguished.** — Sales of railroads by one corporation to another have been, perhaps, the least common form of intercorporate relations. A conjunction of interests has usually been obtained by consolidation, lease, or by the purchase of controlling stock interests. Sales of railroads in foreclosure proceedings have, on the other hand, frequently taken place. The numerous railroad reorganizations in the past ten years have, in nearly every case, required a sale of the railroad and franchises. There have also been instances of the sale of railroads upon execution.

Conventional sales of railroads involve relations between corporations. Judicial sales involve relations between a corporation and its creditors. The former fall within, the latter without, the scope of this treatise.<sup>1</sup>

§ 141. **Distinction between Relation of Vendor and Vendee and Other Intercorporate Relations.** — A sale has already been distinguished from a *consolidation* in that the element of succession to rights and liabilities is present in the latter and absent in the former.<sup>2</sup> The same distinction exists between a sale of a railroad and the form of *reorganization* wherein the stockholders of a railroad company turn over its property and franchises to another corporation, generally formed for the purpose, in exchange for its shares, and divide them directly, or through a distribution, *pro rata* among the stockholders.<sup>3</sup>

<sup>1</sup> A railroad company is a *quasi*-public corporation. The rules governing the sales of property of that class of corporations, considered in §§ 127-129, *ante*, apply to railroad companies. A railroad company exercises franchises, and in their disposition is controlled by the principles examined in the last chapter. Sales of railroads, however, often involve questions peculiarly applicable to them, and there are many statutes especially relating to them. A separate examination of the subject — although involving some repetition

of principles — is, therefore, believed to be desirable.

<sup>2</sup> *Ante*, § 13: "*Distinction between Consolidation and Sale.*"

<sup>3</sup> The term "reorganization" is more commonly, and perhaps more exactly, applied to an arrangement between the stockholders and creditors of an insolvent corporation to form a new corporation to take over the assets of the old upon foreclosure sale. Reorganizations in the manner stated in the text have, however, frequently been made. See 3 Cook on Corp. § 884.

In case of a sale for a valuable consideration and free from fraud, the purchasing corporation takes the property free from charges, except specific liens and equities of which it has notice, and is not liable for the debts of the vendor.<sup>1</sup> In the case of such a reorganization, however, the corporation taking the property in exchange for its shares will be treated as the successor of the old corporation, and, at least to the value of the property received, will be held responsible for its debts.<sup>2</sup>

The distinction between sales of railroads and railroad leases, trackage contracts, pools and other agreements, is self-evident.

§ 142. **Distinction between Sale of Railroad and Sale of Franchises.** — The franchises of a railroad company are special privileges conferred by legislative grant. The railroad of a railroad company is property which may have been acquired by the exercise of its franchises.<sup>3</sup>

The franchises are inalienable, without legislative authority, because a railroad company cannot delegate its powers and shift its obligations.<sup>4</sup> The railroad is inalienable, without like authority, because it is impressed with a trust in favor of the public.<sup>5</sup>

A sale of the franchises of the railroad company alone would not carry its property.<sup>6</sup> A sale of a railroad, without men-

<sup>1</sup> *Ante*, § 123: "*Liability of Purchasing Corporation for Debts of Vendor Company.*"

<sup>2</sup> *Ante*, § 125: "*Remedies of Creditors.*"

<sup>3</sup> *Tuckahoe Canal Co. v. Tuckahoe, etc. R. Co.*, 11 Leigh (Va.), 75 (1840): "Now, I take a franchise to be (1) an incorporeal hereditament; and (2) a privilege of authority vested in certain persons by grant of the sovereign (with us, by special statute), to exercise powers, or to do and perform acts which, without such grant, they could not do or perform. Thus, it is a franchise to be a corporation, with power to sue and be sued, and to hold property as a corporate body. So it is a franchise to be empowered to build a bridge, or keep a ferry, over

a public stream, with a right to demand tolls or ferriage; or to build a mill upon a public river, and receive tolls for grinding, etc. But the franchise consists in the incorporeal right; the property acquired is not the franchise. A bank has a right to purchase a banking house; *when purchased*, is the house a franchise? Surely not, for it is corporeal, whereas a franchise is incorporeal."

<sup>4</sup> See *ante*, ch. XII., subdiv. II.: "*Legislative Authority for Sale of Franchises.*"

<sup>5</sup> See *ante*, § 127: "*Indispensable Property cannot be alienated or taken on Execution without Legislative Authority.*"

<sup>6</sup> That a franchise does not include property gained by the exercise

tioning franchises, would carry those franchises *necessary* for its operation.<sup>1</sup>

## II. Grants of Power to sell and purchase Railroads

§ 143. **Statutory Authority essential to Sale of Railroad.** — As already shown, a sale by a *quasi*-public corporation of its franchises, or of property necessary for the performance of its public duties, is invalid without legislative authority.<sup>2</sup> A railroad company can sell its franchises and indispensable property only when such sale is sanctioned by statute.<sup>3</sup>

Mr. Justice Bradley in *Branch v. Jesup*<sup>4</sup> clearly stated the

thereof, see *Bridgeport v. New York, etc. R. Co.*, 36 Conn. 255 (1869).

<sup>1</sup> See *post*, § 157: "*Essential Franchises pass upon Sale of Railroad.*" *Contra*, *Arthur v. Commercial and Railroad Bank*, 17 Miss. 394 (1848).

<sup>2</sup> See *ante*, §§ 17, 18 ("consolidation"); *ante*, §§ 127-129 ("indispensable property"); *ante*, §§ 135-139 ("franchises"); *post*, § 177 ("leases").

<sup>3</sup> *United States*: *Branch v. Jesup*, 106 U. S. 468 (1882), (1 Sup. Ct. Rep. 495, 9 Am. & Eng. R. Cas. 215); *Mackintosh v. Flint, etc. R. Co.*, 34 Fed. 582 (1888).

*Georgia*: *Singleton v. Southwestern R. Co.*, 70 Ga. 464 (1883), (48 Am. Rep. 574).

*Maryland*: *State v. Consolidation Coal Co.*, 46 Md. 1 (1876).

*Massachusetts*: *Richardson v. Sibley*, 11 Allen (Mass.), 67 (1865), (87 Am. Dec. 700): "A corporation, created for the very purpose of constructing, owning and managing a railroad, for the accommodation and benefit of the public, cannot, without distinct legislative authority, make any alienation, absolute or conditional, either of the general franchise to be a corporation, or of the subordinate franchise to manage and carry on its corporate business, without which its franchise to be a corporation can have little more than a nominal existence."

*Nebraska*: *Clarke v. Omaha, etc. R. Co.*, 5 Neb. 314 (1877).

*New York*: *Troy, etc. R. Co. v. Boston, etc. R. Co.*, 86 N. Y. 117 (1881): "It is well settled that, unless authorized thereto by statute, a railroad corporation, organized under our General Railroad Act, has no authority to transfer or lease its road."

*Ohio*: *Coe v. Columbus, etc. R. Co.*, 10 Ohio St. 377 (1859): "In the case of a railroad corporation, its franchises and corporate rights are not alienable, without express statutory authority."

Also *Railroad Co. v. Hinsdale*, 45 Ohio St. 556 (1888), (15 N. E. Rep. 665).

*Pennsylvania*: *Pittsburgh, etc. R. Co. v. Bedford R. Co.*, 81½ Pa. St. 104 (1871).

*Tennessee*: *Frazier v. Railway Co.*, 88 Tenn. 138 (1889), (12 S. W. Rep. 537).

*Texas*: *East Line, etc. R. Co. v. Rushing*, 69 Tex. 306 (1887), (6 S. W. Rep. 834); *Gulf, etc. R. Co. v. Morris*, 67 Tex. 692 (1887), (4 S. W. Rep. 156).

As to legislative ratification of unauthorized sale of a railroad, see *Wood v. Macon, etc. R. Co.*, 68 Ga. 539 (1882).

<sup>4</sup> *Branch v. Jesup*, 106 U. S. 468 (1882), (1 Sup. Ct. Rep. 495, 9 Am. & Eng. R. Cas. 215).

rule and the reasons therefor: "As a general rule, it is true, a railroad company, with only the ordinary power to construct and operate its road, cannot dispose of it to another company. Legislative aid is necessary to that end. . . . Generally the power to sell and dispose has reference only to transactions in the ordinary course of business incident to a railroad company; and does not extend to the sale of the railroad itself, or of the franchises connected therewith. Outlying lands, not needed for railroad uses, may be sold. Machinery and other personal property may be sold. But the road and franchises are generally inalienable; and they are so not only because they are acquired by legislative grant, or in the exercise of special authority given, for the specific purposes of the incorporating act, but because they are essential to the fulfilment of those purposes; and it would be a dereliction of the duty owed by the corporation to the State and to the public to part with them."<sup>1</sup>

Questions as to what constitutes indispensable, and what surplus, property are considered elsewhere.<sup>2</sup>

§ 144. **Seller must have Authority to sell and Buyer to buy.**—From the principle that legislative authority is as necessary to accept a conveyance of franchises as it is to make a grant,<sup>3</sup> it follows that both vendor and vendee corporation must be authorized by statute to enter into a contract for the purchase and sale of a railroad.<sup>4</sup> As said by the Supreme Court of Texas in *East Line, etc. R. Co. v. State*:<sup>5</sup> "To authorize such a trans-

<sup>1</sup> Statutes authorizing *quasi*-public corporations to sell their franchises and property are within the constitutional powers of the legislature. Having power to create the corporation, it has power to authorize the transfer of its franchises and assets. See *Claw v. Van Loan*, 4 Hun (N. Y.), 184 (1875).

<sup>2</sup> See *ante*, 128: "*Test of Indispensability*"; *ante*, § 129: "*Sales of Surplus Property*." Also *post*, § 172: "*Leases of Surplus Property*."

<sup>3</sup> *Ante*, § 139: "*Legislative Authority essential to Purchase of Franchises*."

<sup>4</sup> *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690); *East Line, etc. R. Co. v. Rushing*, 69 Tex. 306 (1887), (6 S. W. Rep. 834).

A railroad company cannot transfer its franchises to a private person so as to enable him to build a railroad and operate it for his own benefit.

*Stewart's Appeal*, 56 Pa. St. 413 (1867); *Fanning v. Osborne*, 102 N. Y. 441 (1886), (7 N. E. Rep. 307).

<sup>5</sup> *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690).

action it must appear that one corporation had power to sell and the other to buy."

Authority granted to one railroad company to purchase the railroad and franchises of a specified corporation gives the latter authority to sell.<sup>1</sup>

**§ 145. What Railroads may be the Subject of Sale. Statutory Provisions.** — Statutes of the different States authorizing sales of railroads are collected in the subjoined note.<sup>2</sup>

<sup>1</sup> New York, etc. R. Co. v. New York, etc. R. Co., 52 Conn. 274 (1884).

<sup>2</sup> *Alabama.* Code 1896 (as amended by Laws 1898-1899), § 1169: "Whenever all of the capital stock of a railroad corporation, chartered under the laws of this State, is owned by a railroad corporation chartered by the laws of another State," the domestic corporation "may sell and convey to the corporation owning its stock all of its property," franchises, etc.

*Ib.* Foreign railroad corporations operating domestic railroad may purchase or lease any other domestic railroad connecting with its own.

*Ib.* § 1170: "Any railroad corporation . . . of this or any other State, may lease or purchase any part or all of any railroad constructed by another corporation . . . if the lines of such roads are continuous or connected."

*Ib.* § 1172: "A corporation . . . has authority, for the purpose of extending its line, or forming a connection, to acquire, hold and operate a railroad without the State."

*Arizona.* R. S. 1901, par. 864, § 1: "Any railroad company . . . may purchase or lease the railroad" franchises, etc., "of any railroad company of this Territory or any other Territory or State. . . . No purchase or lease" shall be made "unless the line of railroad so purchased or leased . . . shall, when constructed, form . . . a branch of, or a continuous line with, the railroad of such purchasing or leasing company either by direct connection

therewith, or through an intermediate line or lines."

*Ib.* Any railroad company may sell or lease its railroad, franchises, etc., to any railroad company, organized under the laws of Arizona, or of any other Territory or State. The lines must be continuous, either directly, or by means of intermediate line or lines.

*Arkansas.* Kirby's Dig. 1904, § 6742: "Any railroad company of this State . . . may sell or lease its road, property and franchises to any other railroad company . . . of any other State . . . whose line of railroad shall so connect with the leased or purchased road by bridge, ferry or otherwise, as to practically form a continuous line of railroad; and any railroad of this State may buy or lease, or otherwise acquire, any railroad or railroads, with all property, . . . whenever the roads shall form, in the operation thereof, a continuous line or lines."

*Ib.* § 6743: "Any railroad company . . . of any other State . . . may buy, lease, or otherwise acquire any railroad or railroads, the whole or part of which is in this State . . . whenever the roads of such companies shall form in the operation thereof a continuous line or lines."

*Ib.* § 6752: "Any railroad company . . . of this or any other State, or of the United States, may lease or purchase all, or any part, of a railroad . . . the whole or part of which is in this State, and constructed,



In nearly all of these statutes the power to sell or purchase is granted in connection with the grant of power to lease or take a lease.

owned or leased by any other company, or connected at any point either within or without this State."

*Ib.* § 6762: "Every railroad corporation . . . of this State . . . is authorized to sell, lease or otherwise dispose of . . . its road," etc., "to any connecting railroad company, or to any railroad corporation . . . of this or any other State."

*Ib.* § 6766: "Any railroad company . . . of any other State" may, for the purpose of continuing its line through this State, "lease or purchase the property . . . of any railroad . . . of this State."

*California.* Pomeroy's Code, 1901, § 494: "Any railroad corporation owning a railroad in this State may sell, convey and transfer its property and franchises . . . to any other railroad corporation . . . of this or any other State or Territory, or [organized] under any act of Congress, and any other such railroad corporation receiving such conveyance may hold and operate."

This section does not authorize any corporation to purchase any railroad property operated in competition with it.

*Colorado.* Mill's Anno. Stat., 1891 (as amended by Sess. Laws 1899, pp. 162-163), § 611: "Any railroad corporation . . . of this State, or . . . of an adjoining State or Territory, may lease or purchase any part or all of a railroad constructed by another company within or without this State, if the lines of roads of such companies are continuous or connected."

Sess. Laws 1899, ch. 125, p. 313: "Any railroad company, owning or operating a line of railroad in this State, may purchase other lines of railroad, within or without this State, which shall connect with the road

operated by such company, directly, or by means of any other line which such company shall have the right, by contract or otherwise, when constructed, to use and operate."

*Ib.* "Any corporation . . . of this State may sell its line of railroad to any other company, to which, under the laws of this State it may lease the same or with which it may consolidate."

*Florida.* Gen. Stat. 1906, § 2812: "Any railroad . . . in this State shall have power . . . to make and enter into contracts with any railroad . . . which has constructed or will hereafter construct any railroad . . . within this State or in another State, as will enable said companies to run their roads in connection with each other, . . . or to lease and purchase the stock and property of any other company, and hold, use, and occupy the same in such manner as they shall deem most beneficial to their interests."

*Georgia.* Code, 1895, § 2179: "Any railroad company incorporated under . . . this article shall have authority to sell, lease, or transfer its . . . property or franchises to . . . any other railroad company incorporated under the laws of this or any other State or of the United States, whose railroad, within or without this State, shall connect with or form a continuous line with the railroad of the company incorporated under this law. Conversely, any such corporation organized under the provisions of this article may purchase . . . the property and franchises of any other railroad company . . . of this or any other State or of the United States whose railroads within or without this State shall connect with or form a continuous line or system with the

As a general rule a railroad company, in these statutes, is expressly authorized to sell its railroad, property and fran-

road of such company incorporated under this law."

*Ib.* § 2173: "A railroad company shall have power . . . to lease or purchase the property of any other such company [one whose road connects with that of purchasing or leasing corporation] and hold, use and occupy the same in such manner as they shall deem most beneficial."

*Idaho.* Laws 1901, p. 214: "Any railroad corporation whose line is wholly or in part within this State whether . . . organized under the laws of this State or of any other State or Territory or of the United States, may lease or purchase . . . the whole or any part of the railroad of any other railroad corporation. . . . Any railroad company may sell or lease the whole or any part of its railroads . . . to any railroad company . . . of the United States or of this State or of any other State or Territory of the United States."

*Illinois.* R. S. 1903, § 196, p. 1475: Domestic railroad corporations operating foreign or domestic railroads may purchase same. No parallel or competing lines can purchase one another.

*Ib.* § 218, p. 1480: "Whenever a corporation . . . of another State shall be in possession of a railroad, the whole or a part of which is situated in this State, belonging to a corporation . . . of this State, or shall own or control all the capital stock of such corporation of this State, then the corporation of this State may sell and convey, and such other corporation of another State . . . may purchase in fee simple all the railroad of the corporation in this State."

*Indiana.* Burns' Anno. Stat. 1901, § 5215: "Any railroad company, incorporated under the provisions of this act, shall have the power and authority to acquire, by purchase or

contract, the road . . . and franchises of any other railroad corporation or corporations which may cross or intersect the line of such railroad company, or any part of the same, or the use and enjoyment, in whole or in part," may also purchase or contract for the use and enjoyment thereof, in whole or in part, of any railroads lying within adjoining States. . . . [This act does not authorize] "any railroad company organizing under the same to . . . acquire . . . the road . . . [or] franchises of any railroad already built, equipped and operated within the State of Indiana and which may cross and intersect the line of railroads organizing under this act; but the powers . . . are . . . limited . . . to such roads within the State . . . as may cross or intersect the same and which have not been equipped and operated in whole or in part."

*Iowa.* Code 1897, § 2066: "Any railroad corporation may sell or lease its property and franchises to . . . any corporation owning or operating any connecting railway."

*Kansas.* G. S. 1897, ch. 70, § 95: "Any railroad company of this State may sell or lease . . . its railroad and branches . . . to any railroad company . . . of this State or of any other State or Territory of the United States. . . . No purchase . . . shall be entered into unless the line of railroad so purchased . . . shall . . . form a continuous line with the road of the company purchasing either by direct connection therewith, or through an intermediate line or lines."

*Ib.* § 51: Domestic corporations may extend their lines into other States and purchase or lease lines of railroad in such States, provided that such lines are connected, forming a continuous line.

chises; but in some cases the power is confined to the sale of the railroad, in whole or part.

*Maine.* R. S. 1903, § 30, p. 531: No corporation can assign its charter or any right under it; lease or grant the use or control of its road, or any part of it, without the consent of the legislature.

*Maryland.* P. G. L. 1904, Art. 23, § 279: "Any railroad company incorporated under . . . [particular statutes] shall also have power to purchase or contract for the use and enjoyment, in whole or in part, of any other railroad or railroads lying within or without this State, if the same shall connect with or form a continuous line with the railroad of the company incorporated under said sections."

*Michigan.* Pub. Acts 1901, Act No. 30, p. 50: "Any railroad company . . . of this State" is authorized to "sell, lease, and convey its road . . . rights and franchises . . . to any other railroad company, whether organized within or without this State; and to acquire, by lease or purchase, from the owner of any other railroad such road . . . whether located within or without this State; and . . . the railroad company so purchasing or leasing" may "acquire and use such road, rights and franchises by purchase of stock, or otherwise, . . . said railroads not having the same terminal points and not being competing lines."

Comp. Laws 1897, § 6328: Domestic railroad company being unable to complete its road, may sell to any domestic corporation not owning a competing line.

Pub. Acts 1899, No. 266, § 17, p. 447: Miscellaneous provisions as to sale of unfinished railroads.

*Minnesota.* Laws 1899, ch. 229, p. 253: "Any railroad corporation, either domestic or foreign . . . may lease or purchase or in any way be-

come the owner of, or control or hold the stock of any other railroad corporation when their respective railroads can be lawfully connected and operated together so as to constitute one continuous main line . . . and in case such lease or purchase shall be made by a foreign corporation" such corporation shall have the same rights as the vendor company.

G. S. 1894, § 2721: "Any railroad corporation may . . . purchase or lease any railroad constructed by any other corporation whose lines of roads are continuous or connected with its own."

*Missouri.* R. S. 1899, § 1060: "A railroad company may aid other railroad companies by purchase and "any railroad company . . . of this or any other State or of the United States may lease or purchase all or any part of a railroad with all its privileges, rights, franchises, real estate and other property, the whole or part of which is in this State, if the lines of road or roads of such companies are continuous or connected at a point, either within or without this State, upon such terms as may be agreed between the companies respectively."

*Ib.* § 1061: "Any railroad company . . . of this State . . . may acquire any line of railroad within or without this State which shall form a continuous line with the road operated by such company, by direct connection or over any other line or lines . . . which such company shall have the right, by contract or otherwise . . . to use and operate."

*Montana.* Code 1895, § 912: "Any railroad corporation whose line is wholly or partly within this State, or reaches the boundary line thereof, whether . . . of the State or Territory of Montana, or of the United

In all cases the purchaser must be a railroad company, but, generally, no distinction is made between domestic and foreign corporations as purchasers.

States, or of any other State or Territory, may lease or purchase the whole or any part of the railroad or line of railroad of any railroad corporation. . . . The railroad or line of railroad so leased or purchased" must be "continuous of or connected with its own line."

*Ib.* § 923: "Any company . . . within this State may . . . buy or lease any railroad or railroads in any other State or Territory, or . . . any other railroad in this State . . . ; or any railroad company may sell or lease the whole or any part of its railroad or branches within this State . . . to any railroad company . . . of the United States, or of this State or of any other State or Territory of the United States."

*Nebraska.* Comp. Stat. 1901, § 4024: "Every railroad company . . . of this State whose railroads . . . within this State shall be so situated with reference to any railroad constructed through any adjoining State or Territory by any railroad company of the United States, or any State or Territory, that the same may be so connected at the boundary line of this State or at any point within this State, by bridge, ferry, or otherwise, as to practically form a continuous line of railway over which cars may pass, is hereby authorized to purchase such connecting railway, or to sell the same to the railroad company" that owns or operates, etc., said railroad through the adjoining State, to said point of connection.

*Ib.* § 1769: "Any railroad company, existing in pursuance of law, may lease or purchase . . . any railroad . . . if said companies' lines of railroad . . . are continuous or connected."

See also *ib.* §§ 4018, 4019, 4026.

*Nevada.* Laws 1901, p. 51: "Any railroad corporation owning any railroad in this State may sell . . . its property . . . to any other railroad corporation . . . of this State or of any other State or Territory; or under any act of Congress."

*New Jersey.* Laws 1900, ch. 46, p. 70: "Whenever any railroad corporation of this State shall own all the bonds and shares of stock of any other railroad corporation of this State whose railroad . . . connects with the railroad of said first-mentioned corporation" it may acquire, have, hold, use, etc., all the rights, etc., of the corporations so controlled.

*New Mexico.* Comp. Laws 1897, § 3891. "Any railroad organized in pursuance of law either within this or any other Territory, or State, may lease or purchase any part or all of any railroad constructed, owned, or leased by any other company."

*New York.* R. S. 1901 (Birdseye's) Railroad Law, § 79: "Any corporation . . . of this State, or its successors, being the lessee of any other railroad corporation may take a surrender of the capital stock of the stockholders or any of them in the corporation whose road is held under lease." The lessee corporation may issue in exchange therefor its own stock at par. When the greater part of the capital stock of the lessor corporation is so acquired the directors of the lessee corporation become *ex officio* directors of the lessor corporation, and when the whole of the capital stock is acquired and a certificate thereof filed with the Secretary of State, the estate, property, franchises, etc., of the lessor corporation vest in the lessee corporation and may be managed and controlled by its di-

The right to purchase and sell is usually limited to corporations owning connecting or continuous lines of road. The

rectors. Rights of creditors and existing liabilities of the lessor corporation are not affected by the transfer.

*North Dakota.* Rev. Codes 1899, § 2954: "Any such railroad corporation [of this State or Territory of Dakota or existing by consolidation of railways of such State or Territory and of any other Territory or State] may lease or purchase and take by conveyance or assignment the railroad franchises . . . of any other railroad corporation, or any portion thereof within or without this State, when their respective railroads can be lawfully connected and operated together to constitute one continuous main line, or when the roads so purchased will constitute branches or feeders of any road maintained and operated by such purchasing corporation."

*Ohio.* Bates' Anno. Stat. 1787-1906, § 3300: "Any company may lease or purchase any part or all of a railroad constructed or in the course of construction by another company, if the lines of road of such companies are continuous or connected . . . upon such terms as may be agreed upon by the companies."

*Ib.* § 3409: A railroad company unable to complete its road may sell to any domestic railroad company authorized to operate over the same route.

*Oklahoma.* Rev. and Anno. Stat. 1903, § 99, p. 360: "Any railroad corporation whose line is wholly or in part within this Territory, whether . . . of this Territory, or of any other State or Territory, or of the United States, may lease or purchase and operate the . . . railroad of any other railroad corporation . . . when such railroads can be lawfully connected and operated together so as

to constitute a continuous main or branch line."

*Oregon.* Hills' Anno. Laws 1892, ch. 32, § 3221, subdiv. 7: Railroad companies have power "to lease or purchase, maintain and operate any part or all of any other railroad constructed by any other company upon such terms and conditions as may be agreed upon between said companies respectively."

No parallel or competing lines are authorized to lease or purchase.

*Pennsylvania.* Laws, 1901, Act No. 20, p. 53: "It shall be lawful for any railroad corporation of this commonwealth, having a railroad connecting with that of any other like corporation, and owning at least two-thirds of the capital stock of the latter, to acquire in the manner hereinafter provided, and thereafter be possessed of, own, hold, exercise and enjoy, all the franchises, corporate property, rights and credits then possessed, owned, held or exercised, by said last-mentioned vendor corporation."

*South Carolina.* R. S. 1893, § 1624: "Railroad companies . . . of this State . . . may . . . enter into contracts for the purchase, use or lease of other railroads . . . and may run, use and operate such road or roads in accordance with such contract or lease: Provided that the roads of the companies so contracting or leasing shall be directly, or by means of intervening railroads, connected with each other."

*Ib.* § 1542: "Every railroad company incorporated in this State shall have all the rights, powers . . . set forth in this article."

*Ib.* § 1546: "Such company shall have the power and authority . . . to purchase, lease, . . . any other railroad or railroads in or out of this

considerations of public policy inducing this limitation have already been considered in connection with similar provisions in consolidation statutes.<sup>1</sup>

State, in such manner and upon such terms as may be agreed between such railroad companies."

*South Dakota.* Rev. Code, § 494, p. 649: "Any railroad company may sell or lease the whole or any part of its railroad or franchises within this State . . . to any railroad company . . . of the United States, or of this State, or of any other State or Territory of the United States."

*Tennessee.* Code 1896, § 1509: "Every railroad corporation in this State . . . shall have the power to" buy "any railroad . . . belonging to any other railroad corporation."

*Ib.* § 1521: "Any and all railroad companies . . . of this State, or of this State and any other State or States, whose charters of incorporation were or may be granted by this State," may "acquire the line or lines of any other railroad company either in this State or any other State or States, which may connect with or form parts and parcels or branches or extensions of the line of such company chartered by this State" and may "so acquire branches or extensions by purchase, lease or otherwise."

*Ib.* § 1540: "Railroad companies of this State" may "lease or let, acquire by purchase, lease or otherwise . . . any railroad or railroads in any State or States, or any parts or portions of any such railroads . . . as may be determined upon by the stockholders."

*Utah.* Laws 1901, ch. 26, p. 21, § 3: "Any corporation owning any railroad line in this State may sell, convey, and transfer its property and franchises . . . to any railroad corporation (not owning any competing line) in this State whether organized under the laws of this State or of any

other State or Territory, or of any act of Congress."

*Ib.* § 4: "Railroad corporations may be formed, pursuant to the laws of this State, for the purpose of buying or leasing a corporation or corporations whose lines of railroad are situated within or without this State, or partly within and partly without this State."

*Washington.* Ballinger's Anno. Codes and Stat. 1897, § 4304: "Any railroad corporation whose line is wholly or in part within this State, whether chartered by or organized under the laws of this State, or any other State or Territory, or of the United States, may lease or purchase the railroad of any other railroad corporation."

*West Virginia.* Code 1906, § 2346: (1) Same as "consolidation" statute (see *ante*, § 22), adding words "purchase" and "sell" to "consolidate."

*Wisconsin.* Sanborn's Supp. (1899-1906), vol 3, § 1833, p. 919: "Any such railroad corporation [see *ante*, § 22, "consolidation"], may give or take a lease or may sell to, or purchase from, any railroad company . . . within or without the State, and give or take a conveyance of the railroad franchises . . . of any railroad corporation . . . of this State, or of any other State, or of the United States, or any portion thereof, within or without the State, when their respective railroads can be lawfully connected and operated together to constitute one continuous main line, or when the road so purchased or leased will constitute a branch . . . or be connected or intersected by, any line maintained and operated by such purchasing

<sup>1</sup> See *ante*, § 22: "What Railroads may consolidate — Statutory Provisions."

It will be observed that the New York statute relates rather to *succession* than to purchase and sale.

§ 146. **Construction of Statutes.** — A railroad company obtains power to sell its railroad and franchises, or to purchase the railroad and franchises of another corporation, only when it is distinctly conferred by statutory authority. Such power will not arise by implication unless necessary to give effect to the language employed in a statute. Any ambiguity in the terms of the grant will operate against the corporation claiming the power.<sup>1</sup>

In *Wood v. Bedford, etc. R. Co.*<sup>2</sup> Judge Sharswood said: "The general canon of construction applicable to legislative grants of this class, derogating as they do from common right and public policy, requires that the intention should be very manifest; if not to be unequivocally expressed, at all events not to depend upon ambiguous phrases rendering the implication doubtful."

Power to purchase does not include power to sell.<sup>3</sup> Authority to sell is not implied from a grant of authority to mortgage.<sup>4</sup> Authority granted to one railroad company to "purchase, lease, hold and maintain any other railroad" does not confer upon other railroad companies implied authority to

or leasing corporation, or which such purchasing or leasing corporation is authorized to build, own, maintain or operate."

*Wyoming.* R. S. 1899, § 3206: "Any company owning or operating a railroad within this State may extend the same into any other State or Territory, and may . . . buy, lease or consolidate with any railroad or railroads in such other State or Territory, or with any other railroad in this State, and may operate the same. . . . Any railroad may sell or lease its railroad or branches within this State . . . to any railroad company . . . of the United States, or of this State, or of any other State or Territory of the United States."

<sup>1</sup> *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 455 (1873). *Com-*

*pare* decision of the Chancellor in the same case, 22 N. J. Eq. 130 (1871).

<sup>2</sup> *Wood v. Bedford, etc. R. Co.*, 8 Phila. (Pa.) 95 (1871).

<sup>3</sup> *Southern Pac. R. Co. v. Esquibel*, 5 N. Mex. 123 (1889), (20 Pac. Rep. 109). Whether power to consolidate includes power to sell, see *ante*, § 28: "*Construction of Particular Statutory Provisions.*"

<sup>4</sup> *Southern Pac. R. Co. v. Esquibel*, 5 N. Mex. 123 (1889), (20 Pac. Rep. 109). "It was argued for the appellant that, if the land could be mortgaged for the means to construct, equip, and operate the road, it could be assigned, in the first place, for the same object. The doctrine that a power to mortgage includes a power to sell is not supported by authority of law."

sell.<sup>1</sup> Authority to purchase the railroad of a specified corporation, however, empowers the latter corporation to make the sale.<sup>2</sup> Power to sell a constructed railroad does not authorize the sale of road before it is finished;<sup>3</sup> nor can a transfer of franchises be justified under a statute permitting the lease of a completed railroad.<sup>4</sup> Power to sell or purchase will not be implied, in favor of a non-competing railroad, from a statute prohibiting the execution of a contract of sale between competing roads.<sup>5</sup>

"Power to buy a railroad cannot be implied from an express grant of power to 'construct, own, maintain and operate' a railroad to be constructed by the corporation to which those express powers are given, for the existence of such a power is not necessary to accomplish the object specified."<sup>6</sup> A grant of power to a railroad company to locate and construct branches to its main road does not include authority to purchase the railroad of another company constructed under a different charter.<sup>7</sup>

Where, however, the sale of a railroad and franchises is distinctly authorized by statute a sale may be effected although thereby the objects for which the corporation was created are defeated.<sup>8</sup> Authority "to have, purchase, possess, enjoy

<sup>1</sup> *State v. Consolidation Coal Co.*, 46 Md. 1 (1876).

<sup>2</sup> *New York, etc. R. Co. v. New York, etc. R. Co.*, 52 Conn. 274 (1884).

<sup>3</sup> *Clarke v. Omaha, etc. R. Co.*, 4 Neb. 458 (1876).

Under a statute authorizing a corporation chartered for the purpose of constructing or operating a railroad to purchase any part of a road constructed by any other corporation if the roads are continuous or connecting, a railroad company has power to convey a part of its right of way to a connecting line in aid of its construction.

*Coyne v. Warrior Southern R. Co.* 137 Ala. 553 (1903) (34 So. Rep. 1004).

<sup>4</sup> *Pittsburgh, etc. R. Co. v. Bedford, etc. R. Co.*, 81½ Pa. St. 104

(1871); *Wood v. Bedford, etc. R. Co.*, 8 Phila. (Pa.) 94 (1871).

<sup>5</sup> *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690).

<sup>6</sup> *East Line, etc. R. Co. v. Rushing*, 67 Tex. 692 (1887), (4 S. W. Rep. 156).

Where, however, a railroad company was authorized to construct its main line between certain points and "to build branches or extend its line into one or more towns" it was held that it had power to purchase a railroad already constructed and to use it as a branch road.

*Central Trust Co. v. Washington Co. R. Co.*, 124 Fed. 813 (1903).

<sup>7</sup> *Campbell v. Marietta, etc. R. Co.*, 23 Ohio St. 168 (1872).

<sup>8</sup> *Mahaska County R. Co. v. Des Moines, etc. R. Co.*, 23 Iowa, 437 (1870).



and retain lands, rents, hereditaments, goods, chattels and effects, of whatsoever kind, nature or quality " sanctions the purchase of a railroad.<sup>1</sup> A statute authorizing " any railroad company " to purchase the railroad and franchises of a particular corporation authorizes such purchase by a railroad company of another State.<sup>2</sup>

§ 147. **Constitutional and Statutory Prohibitions of Purchase of Competing or Parallel Lines.** — The purchase by a railroad company of a line of railroad competing with, or parallel to, its own is prohibited in many constitutional and statutory provisions, in connection with similar prohibitions against consolidations and leases. These provisions, their construction and application, have already been fully considered.<sup>3</sup>

<sup>1</sup> *Branch v. Atlantic, etc. R. Co.*, 3 Woods (U. S.), 481 (1879).

For construction of particular statutory and constitutional provisions relating to sales of railroads and franchises, see *Mackintosh v. Flint, etc. R. Co.*, 34 Fed. 582 (1888); *Venner v. Atchison, etc. R. Co.*, 28 Fed. 581 (1886); *People v. Stanford*, 77 Cal. 360 (1888), (18 Pac. Rep. 85, 2 L. R. A. 92); *Barley v. Southern R. Co.*, 61 S. W. Rep. 31 (1901).

<sup>2</sup> *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 397 (1888), (23 Atl. Rep. 529). Chief Justice Doe said: "Express consent is given to a purchase by 'any railroad company.' Taken without qualification this clause includes foreign as well as domestic railroad corporations. The words 'any railroad company' might be used in a connection and for a purpose that would show a restricted sense not including foreign companies. Here is no evidence to exclude them."

A statute authorizing a foreign railroad corporation, in possession or control of a domestic railroad, to purchase the latter, but providing that it should not be so construed as to permit the purchase of a parallel or competing line in the State, was

held not to authorize the purchase of a line extending along one side of the boundary river within the State by a foreign corporation owning a parallel road on the opposite side of the river in another State.

*Illinois State Trust Co. v. St. Louis, etc. R. Co.*, 208 Ill. 419 (1904) (70 N. E. Rep. 357).

<sup>3</sup> See *ante*, ch. III.: "*Constitutional and Statutory Restraints upon Consolidation.*"

Upon a further hearing of the case referred to in the preceding note (*Illinois State Trust Co. v. St. Louis, etc. R. Co.* 208 Ill. 419 (1904) (70 N. E. Rep. 357)), the Court found that the two roads were, in fact, neither competing nor parallel, it appearing that the foreign line between the two termini was much longer and more indirect than the local road, requiring a change of cars and ferrying; that no through trains were operated on the former and no through business solicited, and that no facilities were provided for through business nor rates made thereon in competition with the local road.

*Illinois State Trust Co. v. St. Louis, etc. R. Co.*, 217 Ill. 504 (1905) (75 N. E. Rep. 562).

The Court said (p. 515): "It, therefore, very plainly appeared

### III. *Authorization and Execution of Contract of Sale*

§ 148. **Statutory Requisites.** — The statutes of the different States prescribing the method to be followed in authorizing and executing sales of railroads are referred to in the footnote.<sup>1</sup>

from all the testimony that the Valley railroad, at either terminus or at any intervening point, was not and is not a competing line of road with that of the appellee and is not a parallel line of road either within the technical geometrical definition of the word 'parallel' or under the more enlarged and practical meaning which, where the element of competition is present should be given the term 'parallel lines' as employed in the statute under consideration."

A statute authorizing a railroad company to purchase a competing portion of the road of another company and to operate it, violates the provision of the Mississippi Constitution, prohibiting legislation suspending the operation of general laws for the benefit of any individual or corporation, since it has the effect of suspending the operation of the general law forbidding competing railroad companies to operate parallel lines within twenty miles of each other, or to purchase the lines of each other or any part thereof.

*Yazoo etc. R. Co. v. Southern R. Co.*, 83 Miss. 746 (1904) (36 So. Rep. 74).

<sup>1</sup> *Arizona*. R. S. 1901, par. 864, § 1: Assent of holders of two-thirds of entire corporate stock — by vote or in writing — necessary to contract of sale.

*Alabama*. Code 1896, §§ 1170, 1173: Approval of holders of majority in value of stock of vendor and vendee corporations at meeting called for the purpose required.

*Arkansas*. Kirby's Dig. 1904, §§ 6742, 6752, 6762: Assent of holders of two-thirds of capital stock is necessary.

*California*. Pomeroy's Code 1901, § 494: Contract of sale must be authorized by directors and ratified by three-fourths of stockholders of both corporations.

*Colorado*. Mills' Anno. Dig. 1891, § 612. Also Sess. Laws 1899, ch. 125, p. 313: Assent of holders of two-thirds of capital stock of each company required.

*Illinois*. R. S. 1903, §§ 196, 218: Approval of holders of two-thirds of capital stock required.

*Kansas*. G. S. 1897, § 95: Sale must be ratified by vote of two-thirds of capital stock of each company, or approved by such holders in writing.

*Michigan*. Comp. Laws 1897, § 6328: Consent of two-thirds of stockholders required for sale of uncompleted road. Consent of majority sufficient under 1901 Act (P. A. 1901, Act No. 30, p. 50).

*Minnesota*. G. S. 1894, §§ 2721, 2736: Sale must be approved by holders of two-thirds of capital stock of each company at meetings called for the purpose.

*Missouri*. R. S. 1899, § 1060: Holders of a majority of stock of each company must assent in writing to sale proposed by directors before it can be perfected.

*Montana*. Code 1895, § 912, requires approval of three-fifths of stockholders. *Ib.* § 923 requires approval by majority vote or by majority in writing. Apply to sales under different statutes.

*Nebraska*. Comp. Stat. 1901, § 1769: Sale must be assented to by vote of holders of two-thirds of capital stock; (§ 4026) by vote or written approval of like number.

The State may withhold the grant of power to sell entirely or may attach such conditions to its exercise as it may deem expedient. These conditions — as distinguished from mere directions — must be strictly complied with. They are conditions precedent to the validity of the sale.

As a general rule, these statutes prescribe three steps in the authorization and execution of a contract of sale:

1. The contract must be approved by the boards of directors of both vendor and vendee companies.
2. It must be submitted to and approved by the prescribed majority of the stockholders of each company.
3. It must be formally executed in behalf of each corporation by agents appointed for the purpose.

**§ 149. Assent of Stockholders. Whether Approval of Majority is sufficient.** — As shown in the last section, statutes authorizing sales of railroads generally prescribe the number of stockholders whose consent is necessary.

Where, however, the statute merely grants power to sell, questions may arise as to the manner of exercising the power.

*Ib.* §§ 4018, 4019, authorize approval of certain sales by majority vote.

*New Jersey.* Laws 1900, ch. 46, p. 70: Acquisition effected by written agreement executed pursuant to resolution adopted by directors of each company.

*New Mexico.* Comp. Laws 1897, § 3891: Holders of two-thirds of capital stock must assent to sale.

*North Dakota.* Rev. Codes 1899, § 2954: Sale must be approved in same manner as consolidation. See *ante*, § 52: "*Formal Statutory Requisites*" (consolidation).

*Ohio.* Bates' Anno. Stat. 1787-1902, §§ 3301, 3411: Two-thirds of stockholders must approve sale at meeting called by each corporation.

*Pennsylvania.* Laws 1901, p. 52, Act No. 20: Agreement adopted by directors must be approved by majority of stockholders of each corporation present at meeting called for the purpose.

*South Dakota.* Rev. Code, § 494

p. 649: Sale must be approved in same manner as consolidation. See *ante*, § 52: "*Formal Statutory Requisites*" (consolidation).

*Tennessee.* Code 1896, § 1540: Sale must be approved by votes of holders of three-fourths of capital stock.

*West Virginia.* Code 1906, § 2346: Sale under first part of statute requires approval of majority of stockholders; under second part two-thirds. Also refers to consolidation statute. See *ante*, § 52: "*Formal Statutory Requisites*" (consolidation).

*Wyoming.* R. S. 1899, § 3206: Sale must be approved by vote of holders of a majority of stock, or their written approval must be given.

All the above abstracts should be examined in connection with the statutes collected in note to *ante*, § 145: "*What Railroads may be the Subject of Sale. Statutory Provisions.*"

It may be contended that the grant of authority to sell only waives the rights of the public,<sup>1</sup> and, therefore, that a railroad company — a *quasi*-public corporation — with power to sell, stands in the position of a private corporation with respect to the disposition of its property — that whether unanimous consent is necessary to a sale of a railroad and franchises, where the governing statute is silent, depends upon the principles of law, already considered, applicable to private corporations.<sup>2</sup>

Upon principle, however, it seems the better view that authority granted a railroad company to sell its road and franchises is an express power of the corporation; and that it may be exercised, unless otherwise provided, in the same manner that other primary corporate powers are exercised — by a majority vote of the stockholders.<sup>3</sup> As said by the Supreme Court of Mississippi in *Hinds County v. Natchez etc. R. Co.*:

<sup>1</sup> *Knoxville v. Knoxville, etc. R. Co.*, 22 Fed. 763 (1884): "The authority thus given to any railroad company to buy necessarily implies authority to other companies to sell, inasmuch as there could be no purchase without corresponding sale. But it was not competent for the legislature to do more in this respect than to waive the public rights. It could not divest or impair the rights of the shareholders, as between themselves, as guaranteed by the company's charter, without their consent. It was upon the faith of the stipulations contained in said charter that the shareholders subscribed to the capital stock, and thereby made themselves members of the corporation. These stipulations, as we have already seen, contemplated and provided for the construction of a railroad between the *termini* named, to be governed by the shareholders, in the manner and upon the terms prescribed. Each corporator is entitled to have the contract fairly interpreted and honestly enforced. The charter invests the owners of a majority of the capital stock with the right to control the

corporate business within the scope of its provisions. Within this limit, the power of the majority, when acting in good faith, is supreme. But complainant's charter does not, by any reasonable intendment, clothe the majority with authority to sell the company's franchise and property, and in this way coerce the minority and protesting shareholders into another and different corporation, owning and operating another and different railroad, under another and different charter imposing other and different obligations, and governed by a different set of operators. To so hold would be to divest them of their vested rights and force them into relations and subject them to duties and obligations which they have not, and probably would not, have voluntarily assumed."

<sup>2</sup> See *ante*, ch. XI., subdiv. 1: "*Sales of Property of Private Corporations.*"

<sup>3</sup> See *post*, § 189: "*Whether Unanimous Consent is necessary unless otherwise provided.*"

<sup>4</sup> *Hinds County v. Natchez etc. R. Co.* 85 Miss. 599 (1905), (38 So. Rep. 189).

In *Louisville etc. R. Co. v. Jarvis*

“ Even in the absence of express statutory authority a private corporation doing a losing and unprofitable business may sell its entire assets, upon a vote of the majority of the stockholders. . . . It is true that a railroad corporation has *quasi* public functions but when the State by a valid statute has consented to the sale all difficulty on this account is removed. Whatever interest the State might have in the continued ownership and operation of the road by the corporation this interest was certainly committed to the legislature.”

Unquestionably, the assent of at least a majority of the stockholders is essential. Unless the power is distinctly conferred by statute or by-laws upon the directors, they have no authority to sell the railroad or franchises of their corporation, in whole or in part.<sup>1</sup>

(Ky. 1905), 87 S. W. Rep. 759 where the charter of a railroad company was amended by providing that no contract which the president and directors might make with any other railroad company should be valid until “ratified by the stockholders” it was held that a contract for the sale of the road did not require the unanimous vote of the stockholders — that a majority vote was sufficient. The Court said (p.761): “It seems to us more reasonable to presume that the legislature meant by the expression ‘ratified by the stockholders of this company’ only to require the directors to bring all those contracts which, under section 21 of the original charter, they were authorized to make without the approval of the stockholders, before a stockholders’ meeting for ratification — not by the unanimous vote of the stockholders, but by a majority. It requires but little observation to know that the trend of railroad development has been constantly from isolated fragments of railway lines towards consolidation into grand trunk lines, and that in proportion as this has been successfully accomplished has the great usefulness of this branch of the common carriers

of traffic and passengers of this country been increased. It therefore would seem to follow, as a natural and logical conclusion, that it is much to the interest of small and fragmentary lines that they should be enabled with the utmost facility, consistent with the preservation of the rights of the owners, to enter into contracts of consolidation or sale with other railroads, whereby they may become parts of great systems of interstate traffic, rather than remain small, isolated lines. To require the unanimous vote of all the stock of a railroad to unite with another railroad, or to sell its franchises out to another railroad, if that be desirable, is to render this method of developing the interests of the corporation impracticable, as it simply provides an opportunity for a small number of the stockholders to entirely block the interest of the great majority of the stock for their own selfish purposes. It needs but little understanding of human nature to believe that the opportunist will be ready whenever the opportunity is presented.”

<sup>1</sup> See *ante*, § 112: “*Sale of Entire Corporate Property by Directors.*”

In *Martin v. Continental Passenger*

§ 150. **Acquiescence of Stockholders.** — The assent of the stockholders of a railroad company to the purchase or sale of a railroad should, regularly, be expressed in the manner provided in the statute authorizing the sale; and, in the absence of other statutory provision, by their votes at stockholders' meeting. Acquiescence, however, is an implied sanction of a sale.<sup>1</sup> Stockholders who stand by and take no action until the rights of third persons intervene lose their right to question sales of railroads made without their approval.<sup>2</sup> Stockholders who participate in the transaction cannot, after its consummation, question its validity, although their formal votes were lacking.<sup>3</sup>

§ 151. **Rights and Remedies of Dissenting Stockholders.** — It is well settled that equity will restrain, at the instance of a single stockholder, a majority of the stockholders of a corporation, acting in its name, from entering into *ultra vires* or unlawful contracts. Minority stockholders acting with due diligence may sue for an injunction against the unauthorized sale

R. Co., 14 Phila. (Pa.) 10 (1880), the Court said: "Boards of managers are simply the agents of the corporation which, like natural persons, is bound only by the acts and contracts of its agents, done within the scope of their authority. The business of the directors of a railway is to manage the business intrusted to their charge. To give it away or sell it, or in any way put it out of their control, and to delegate to others the power which has been intrusted to them, is clearly in excess of their authority."

<sup>1</sup> Boston, etc. R. Co. v. New York, etc. R. Co., 13 R. I. 260 (1881). See also *ante*, § 45: "Assent of Stockholders, how manifested. Acquiescence Estoppel." Also *ante*, § 116: "Defences to Stockholders' Actions. Estoppel."

<sup>2</sup> Dimpfel v. Ohio, etc. R. Co., 9 Biss. (U. S.) 127 (1879), (*affirmed* 110 U. S. 209 (1884)): "In the second place, even if the right did not clearly exist by virtue of the laws of Illinois, after the lapse of so long a time, and

after so many rights and equities have been acquired by different parties under the action of the railway company, it is not competent for the plaintiff, or the other stockholders of the Ohio and Mississippi Railway Company, any more than for the company itself to question the authority under which the contract and mortgage were executed. The only power that could do that was the State itself."

<sup>3</sup> Where the charter of a railroad company authorized it to purchase railroads which might form a continuation of its main line; and where such purchase had been fully executed, and where its validity had never been questioned in a direct proceeding, it was held the parties to such purchase — those who acquiesced in it, and those who failed in due time, by some proper proceeding, to question its validity — were estopped to raise any question. *Hervey v. Illinois Midland Ry. Co.*, 28 Fed. 169 (1884).

of a railroad before its consummation, and for the cancellation of the contract after its execution.<sup>1</sup>

A distinction has been drawn between the right of a dissentient stockholder to restrain an act *ultra vires* the corporation and an act *ultra vires* the majority. Thus, it has been declared that while a stockholder might have an unauthorized sale of a railroad declared illegal no relief could be granted where the prescribed majority sanctioned the sale, although made for stock in the purchasing corporation. Judge Jackson, in *Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*,<sup>2</sup> said: "The sale, being sanctioned by the requisite majority of stockholders, and made by the corporation, as provided and authorized by the general law of the State under which the company was organized, invested the purchasing company with as perfect a title to the property and franchises as was vested in or held by the vendor corporation, and operated to make the purchasing corporation the legal successor of the vendor corporation. It would be paradoxical to hold that such a sale was valid as to the corporation, and invalid as to one of its stockholders who objected thereto, and whose assent was not necessary to give validity to the transaction. It would be equally inconsistent to hold that such a sale, made under and in pursuance of statutory authority in force at the organization of the corporation and at the date of the transaction, should be treated as only binding upon the corporation and the stockholders assenting thereto, and invalid as to a dissenting shareholder whose consent was not a prerequisite to its validity."

The distinction is not well taken. The opinion assumes too much.<sup>3</sup> A sale authorized by the requisite majority of the

<sup>1</sup> See *ante*, § 46: "*Rights and Remedies of Dissenting Stockholders*" (consolidation); *ante*, § 114: "*Remedies of Dissenting Stockholders*" (sales of property).

For extended examination of the rights and remedies of dissenting stockholders in the case of the sale of street railway properties, see *Tanner v. Lindell R. Co.*, 180 Mo. 1 (1904), (79 S. W. Rep. 155).

<sup>2</sup> *Farmers Loan, etc. Co. v. Toledo,*

*etc. R. Co.*, 54 Fed. 767 (1893). See also *Young v. Toledo, etc. R. Co.*, 76 Mich. 485 (1889), (43 N. W. Rep. 632) — another case arising out of the same transactions.

<sup>3</sup> In the case referred to (*Farmers Loan, etc. Co. v. Toledo, etc. R. Co.*, 54 Fed. 775 (1893)), Judge Taft said: "Under the statute of Michigan permitting the sale of an uncompleted railroad by its stockholders to another road, the words of which are quoted

stockholders, according to the statute, does bind the minority. But an exchange of property for stock is not a sale. The prescribed majority have no more power, under a statute authorizing a sale, to make an exchange, than they have to make a donation. A transfer of property for stock *may be ultra vires* of the corporation. It is *ultra vires* of the majority, and may be restrained at the suit of any stockholder.<sup>1</sup>

in the foregoing opinion, there is no power in two-thirds in interest of the stockholders to bind one-third to a sale for any consideration but money or money credit. We have already held in this court, in the case of *Perin v. Megibben*, 53 Fed. Rep. 86 (1892), that a statutory power to sell does not include a power to exchange for shares of stock in a corporation. Nor do I understand the Supreme Court of Michigan to hold, in the case of *Young v. Railroad Co.*, 76 Mich. 485 (1889), (43 N. W. Rep. 632), that it is within the power of two-thirds of the stockholders, under this statute, to bind a minority to a sale for anything but money."

Judge Hammond said (p. 778): "I do not think that any corporation can go out of business, and sell its properties and franchises in entirety (outside of sales made in the ordinary course of business), and bind a minority of the stockholders, by the will of the majority, to such a sale, upon any principle of the public welfare or like consideration; certainly, not to compel the minority, on such a sale, to take chips and whetstones for their shares of stock, — that is to say, anything else than money."

The decision in the case, however, finally turned upon other grounds.

<sup>1</sup> Judge Taft also said, following the extract from his opinion in the last note: "There is no doubt whatever of the proposition urged in the fore-

going opinion, — that a minority stockholder is bound by the acts of the majority so long as that majority acts within its charter powers, — nor is there any doubt that neither the majority nor the entire body of stockholders of the corporation can do a corporate act which its charter forbids; but there are corporate acts which are not within the charter power of the majority of the stockholders, and yet which are not beyond the power of the corporation. There are acts of the corporation, which the State, as the grantor of the corporate franchise, has no interest to invalidate, provided all the stockholders consent thereto. There are acts which, if done by a majority, only infringe upon the charter rights of the minority. In this case the power to sell for money was conferred by statute upon two-thirds of the stockholders of the uncompleted road. The sale could not be for stock in another company, against the objection of the minority stockholders. No such power was vested by the statute in the two-thirds majority. If, however, the minority consented, the State, the grantor of the corporate franchise, had no interest in objecting to the transaction as beyond the corporate power of the company." See also *ante*, § 114: "*Remedies of Dissenting Stockholders in Case of Invalid and Unfair Sales.*"



## CHAPTER XIV

## EFFECT OF EXECUTION OF CONTRACT OF SALE

I. *Rights and Liabilities of Vendor Corporation*

- § 152. Sale of Railroad and Franchises does not terminate Corporate Existence.
- § 153. Rights of Vendor Corporation after Authorized Sale.
- § 154. Liabilities of Vendor Corporation in Case of Authorized Sale.
- § 155. Liabilities of Vendor Corporation in Case of Unauthorized Sale.
- § 156. *Quo Warranto* and other Proceedings against Vendor Corporation.

II. *Rights and Liabilities of Vendee Corporation*

- § 157. Essential Franchises pass upon Sale of Railroad.
- § 158. Rights and Powers of Vendee Corporation — In General.
- § 159. Right of Eminent Domain.
- § 160. Exemptions from Taxation.
- § 161. Right to fix Rates of Fare. Chartered Rates.
- § 162. Obligations of Vendee Corporation in Respect of Public Duties of Vendor.
- § 163. Vendee Corporation not liable upon Obligations of Vendor unless assumed or imposed by Law.
- § 164. Status of Foreign Vendee Corporation.

I. *Rights and Liabilities of Vendor Corporation*

§ 152. **Sale of Railroad and Franchises does not terminate Corporate Existence.** — The sale of all the property of a corporation does not work its dissolution.<sup>1</sup> The sale by a railroad company of its road and franchises, while disabling it from the performance of the functions for which it was created, does not terminate its corporate existence.<sup>2</sup> Its dissolu-

<sup>1</sup> See *ante*, § 117: "*Effect of Sale of Entire Corporate Property.*"

<sup>2</sup> *United States*: *United States v. Little Miami, etc. R. Co.*, 1 Fed. 700 (1880); *Swan Land, etc. Co. v. Frank*, 39 Fed. 456 (1889).

*Alabama*: *Davis v. Memphis, etc. R. Co.*, 87 Ala. 633 (1888), (6 So. Rep. 140).

*Connecticut*: *Saugutuck Bridge Co. v. Town of Westport*, 39 Conn. 337 (1872).

*Delaware*: *Higgins v. Downward*, 8 Houst. 227 (1888), (32 Atl. Rep. 133, 40 Am. St. Rep. 141).

*Illinois*: *Brufett v. Great Western R. Co.*, 25 Ill. 353 (1861); *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439 (1883).

*Indiana*: *DeCamp v. Alward*, 52 Ind. 468 (1876).

*Iowa*: *Muscatine Western R. Co. v. Horton*, 38 Iowa, 33 (1873).

*Massachusetts*: *Richardson v. Sib-*

tion can be accomplished only by the surrender, forfeiture or repeal of its charter.

A sale, however, in pursuance of a statute authorizing a railroad company to sell its franchises, including the franchise to be a corporation, is, in effect, a surrender of the charter.<sup>1</sup> Statutes may also expressly provide that a sale of all its property shall constitute a dissolution of a corporation.<sup>2</sup> But, under such a statute, an illegal or fraudulent sale will not effect a dissolution.<sup>3</sup>

§ 153. **Rights of Vendor Corporation after Authorized Sale.** — As the sale of the railroad and franchises of a railroad company does not *ipso facto* terminate its corporate existence, the corporation necessarily retains the formal powers essential to a nominal existence, to the winding up of its affairs and to the performance of its continuing public duties. It also retains any property and rights not included in the deed of conveyance, or of which the statute does not authorize the sale. Thus, for example, it has been held that power to sell a railroad does not authorize the sale of subscriptions to the stock of the vendor company.<sup>4</sup>

ley, 11 Allen (Mass.), 67 (1865), (87 Am. Dec. 700).

*Missouri*: Heath v. Missouri, etc. R. Co., 83 Mo. 617 (1884).

*New Jersey*: Sewell v. East Cape May Beach Co., 50 N. J. Eq. 717 (1892), (25 Atl. Rep. 929).

*New York*: Troy, etc. R. Co. v. Kerr, 17 Barb. 581 (1854).

*Texas*: Gulf, etc. R. Co. v. Newell, 73 Tex. 334 (1889), (11 S. W. Rep. 342, 15 Am. St. Rep. 788).

<sup>1</sup> Snell v. City of Chicago, 133 Ill. 413 (1890), (24 N. E. Rep. 532, 8 L. R. A. 858); Rogersville, etc. R. Co. v. Kyle, 9 Lea (Tenn.), 691 (1882); Reynolds v. Cridge, 11 Pa. Co. Ct. Rep. 306 (1892).

<sup>2</sup> Under *Pennsylvania* statute of 1901 (Laws 1901, p. 53, Act No. 20), upon filing copy of agreement in office of secretary of the Commonwealth, corporate existence of vendor terminates.

<sup>3</sup> White Mountains R. Co. v. White

Mountains R. Co., 50 N. H. 50 (1870).

<sup>4</sup> In *Railroad Co. v. Hinsdale*, 45 Ohio St. 556 (1888), (15 N. E. Rep. 665), where a person subscribed for stock in a railroad company — subscription payable when road was completed — and the company sold its uncompleted road to another corporation which completed the construction, it was held that the Ohio statutes (Bates' Anno. Stat. 3300 and 3409) authorizing sales of railroads did not confer authority to sell stock subscriptions; that no ownership in the subscription passed to the purchaser of the railroad, and that such purchaser could not fulfil the condition precedent to the payment of the subscription by completing the road.

Compare *Armstrong v. Karschner*, 47 Ohio St. 276 (1890), (24 N. E. Rep. 897), where it was held that a statute authorizing the sale of a railroad, in

§ 154. **Liabilities of Vendor Corporation in Case of Authorized Sale.** — It has been held that the obligations of a railroad company to the public can only be discharged by a sale of its franchises to another company under a legislative enactment authorizing the sale and *exempting* the vendor from liability; that legislative consent is not sufficient — a legislative release is necessary. Upon this doctrine, the Supreme Court of Nebraska held a vendor corporation, after an authorized sale, liable for the torts of the vendee in the operation of the road.<sup>1</sup>

Public policy is declared to be the basis of the doctrine, and it may well be that, unless exempted, a vendor corporation remains liable upon its primary obligations to the State. But when the legislature has authorized a sale, and thereby manifested the policy of the State that the railroad should be owned and operated by the vendee, neither principle nor policy requires that the vendor should be held responsible for the operation of the road of another by persons with whom it has no connection and over whom it can exercise no control.<sup>2</sup>

§ 155. **Liabilities of Vendor Corporation in Case of Unauthorized Sale.** — Whatever question there may be as to the liability of a vendor corporation in case of an authorized sale, it is indisputable that it remains liable for the torts of the vendee in case of an *unauthorized* sale.

A railroad company cannot absolve itself from continued

force at the time of a stock subscription, becomes a part of the contract of subscription, and that a sale by the company of a part of its road does not release a subscriber. *Compare* also *Hays v. Ottawa*, etc. R. Co., 61 Ill. 422 (1871).

A sale by a corporation of its property and franchises does not carry with it stock in its treasury which it has bought in and has not re-issued. *Tulare Irr. Dist. v. Kaweah Canal*, etc. Co. (1896, Cal.), 44 Pac. Rep. 662.

One railroad corporation, having merely bought the road-bed of another, with intent to complete the road, has no right to purchase the vendor's stock subscriptions and enforce them against subscribers. *West*

*End*, etc. R. Co. *v. Dameron*, 4 Mo. App. 414 (1877).

<sup>1</sup> *Cholette v. Omaha*, etc. R. Co., 26 Neb. 159 (1889), (41 N. W. Rep. 1106, 4 L. R. A. 135). See also *Acker v. Alexandria*, etc. R. Co., 84 Va. 648 (1888), (5 S. E. Rep. 688); *Naglee v. Alexandria*, etc. R. Co., 83 Va. 707 (1887), (3 S. E. Rep. 369, 5 Am. St. Rep. 308).

<sup>2</sup> *Pennison v. Chicago*, etc. R. Co., 93 Wis. 344 (1896), (67 N. W. Rep. 702).

For full consideration of this question with reference to the liability of a lessor corporation see *post*, ch. XIX.: "*Rights and Liabilities of Lessor Corporation.*"

liability for negligence by transferring its franchises to another company in the absence of a statute sanctioning the sale.<sup>1</sup>

§ 156. **Quo Warranto and Other Proceedings against Vendor Corporation.** — An attempt by a railroad company to sell its railroad and franchises may furnish ground for the forfeiture of its charter in *quo warranto* proceedings.<sup>2</sup>

Especially is this true where a corporation, in transferring its property and franchises, acts not only without authority but in direct violation of a constitutional provision against a sale to a competing company, and persists in the *non-user* of its franchises.<sup>3</sup>

Of the power of the State to reach a foreign corporation — party to such an unlawful contract — the Supreme Court of Texas, in *East Line, etc. R. Co. v. State*,<sup>4</sup> said: “The courts of this State would have no power to declare a forfeiture of the charter of that corporation granted by the laws of the State where it was created, but would have power to withdraw the franchise here granted, whenever the facts justified it, and, by injunction or otherwise, to prevent its carrying on business in this State in violation of its laws. They would also have power to place property controlled by it and situated in this State in the hands of a receiver, and to adjust the rights of such persons as might be shown to have valid claims against it, or even to avoid a valid incorporation in this State by those interested in property acquired by it in an unlawful manner.”

## II. *Rights and Liabilities of Vendee Corporation*

§ 157. **Essential Franchises pass upon Sale of Railroad.** — A grant of authority to sell a railroad, without expressly including its franchises, embraces by implication the right to transfer those franchises which are essential to the maintenance and

<sup>1</sup> *East Line, etc. R. Co. v. Rushing*, 69 Tex. 306 (1887), (6 S. W. Rep. 834). See also *post*, ch. XIX. . “*Rights and Liabilities of Lessor Corporation.*”

<sup>2</sup> *State v. Minnesota Central R. Co.*, 36 Minn. 246 (1886), (30 N. W. Rep. 816). That a sale of its road by a turnpike company is a ground for the

forfeiture of its charter see *State v. Pawtuxet Turnpike Co.*, 8 R. I. 521 (1867), (94 Am. Dec. 123).

<sup>3</sup> *East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690).

<sup>4</sup> *East Line, etc. R. Co. v. State*, 75 Tex. 451 (1889), (12 S. W. Rep. 690).

operation of the railroad. A sale of a railroad, under statutory authority, carries with it the ordinary franchises necessary for the use of the railroad property and without which it would be useless.<sup>1</sup>

§ 158. **Rights and Powers of Vendee Corporation — In General.** — A grant to a railroad company of power to sell its property and franchises, without limitation, authorizes the sale of all its property and franchises,<sup>2</sup> except the franchise of corporate existence.<sup>3</sup> The vendee corporation, under a sale in pursuance of such authority, may enjoy the property and exercise the franchises as freely as if directly granted to it.

Statutes authorizing the sale of a railroad and franchises sometimes define the *status* of the vendee corporation and designate the rights and franchises acquired by the purchase.<sup>4</sup>

<sup>1</sup> *United States*: *New Orleans, etc. R. Co. v. Delamore*, 114 U. S. 501 (1884), (5 Sup. Ct. Rep. 1009); *Branch v. Jesup*, 106 U. S. 468 (1883), (1 Sup. Ct. Rep. 495). *Contra Pullan v. Cincinnati, etc. R. Co.*, 4 Biss. (U. S.) 35 (1865).

*Alabama*: *Meyer v. Johnston*, 53 Ala. 237 (1875).

*Massachusetts*: *East Boston Freight R. Co. v. Eastern R. Co.*, 13 Allen, 422 (1866).

*Pennsylvania*: *Gloninger v. Pittsburgh, etc. R. Co.*, 139 Pa. St. 13 (1891), (21 Atl. Rep. 211).

*Texas*: *Compare Missouri Pac. R. Co. v. Owens*, 1 Texas App. Civ. Cas. § 385 (1883).

*Wisconsin*: *Pierce v. Milwaukee, etc. R. Co.*, 24 Wis. 551 (1869), (1 Am. Rep. 203).

*England*: *County of Gloucester Bank v. Rudry Merthyr, etc. Co.*, L. R. 1 Ch. 629 (1895).

<sup>2</sup> *Pierce v. Milwaukee, etc. R. Co.*, 24 Wis. 551 (1869), (1 Am. Rep. 203). See also *Sioux City Terminal R. etc. Co. v. Trust Co. of North America*, 82 Fed. 124 (1897); *Threadgill v. Pumphrey*, 87 Tex. 573 (1895), (30 S. W. Rep. 356).

<sup>3</sup> See *ante*, § 132: "*Transferability*

*of Franchise of Corporate Existence.*"

<sup>4</sup> In *Indiana* a purchasing company may mortgage franchises acquired and issue new stock and bonds. (*Burns' R. S.* 1901, § 5215.)

In *Nebraska* the purchasing company is vested with all the property and franchises of the vendor, and may receive municipal aid, etc. (*Comp. Stat.* 1901, § 4018.) Foreign purchasing companies have all the powers and rights of domestic railroad companies (*Ib.* § 4024).

In *Nevada* foreign purchasing companies may hold and exercise franchises to the same extent as if domestic corporations (*Sess. Laws* 1901, p. 51).

In *Ohio* the purchasing company acquires all the rights, privileges and easements of the vendor (*Bates' Anno. Stat.* (1787-1902) §§ 3300, 3384 (d), 3409).

In *Pennsylvania* all rights, property and franchises of vendor vest in acquiring corporation (*Laws* 1901, p. 53, Act No. 20). This statute is of limited application.

In *Utah* the purchasing company is vested with all the rights and franchises of the vendor and of domestic corporations generally; may extend

§ 159. **Right of Eminent Domain.** — Probably the right of eminent domain would not pass by implication, as an essential franchise, under a transfer which included in terms only a *railroad*.<sup>1</sup> But when the conveyance, in pursuance of statutory authority, embraces a railroad and *franchises*, the right of eminent domain passes, with other franchises, to the purchasing corporation.<sup>2</sup> Thus, a purchaser who acquires the property of a railroad company and “all its contracts, franchises, rights, privileges and immunities,” acquires the right of eminent domain.<sup>3</sup>

Where, however, a railroad is sold in sections to different purchasers, the right of eminent domain belonging to the vendor corporation is not parcelled out.<sup>4</sup> A purchasing corporation does not succeed to a right of eminent domain of a peculiar nature granted to a vendor corporation by special statute.<sup>5</sup>

A purchasing corporation does not acquire the right to prosecute condemnation proceedings, pending at the time of the purchase.<sup>6</sup>

§ 160. **Exemptions from Taxation.** — An exemption from taxation is a personal privilege of the corporation to which it is granted. It cannot be transferred, unless the legislature, in authorizing a sale, uses apt words to describe the exemption, as distinguished from other privileges, and

its lines; may lease or purchase connecting lines; may issue bonds and mortgage property, etc. (Laws 1901, ch. 26, p. 21, § 4).

In *Wisconsin* the purchasing company takes all the rights, privileges and immunities of the vendor (Stat. 1888, § 1833, as amended by Laws 1899, ch. 191).

<sup>1</sup> In *Mayor of Worcester v. Norwich, etc. R. Co.*, 109 Mass. 103 (1871), it was held that authority to lease a *railroad* would not confer, by implication, the right of eminent domain upon the lessee. Compare *New Orleans, etc. R. Co. v. Delamore*, 114 U. S. 501 (1885), (5 Sup. Ct. Rep. 1009).

<sup>2</sup> *Lawrence v. Morgan's Louisiana,*

*etc. Co.*, 39 La. Ann. 427 (1887), (2 So. Rep. 69, 4 Am. St. Rep. 265).

In *Arkansas* (S. & H. Dig. 1894, § 6342), *Nevada* (Sess. Laws 1901, p. 51) and *Ohio* (Bates' Anno. Stat. (1787-1902), § 3300), *Wyoming* (R. S. 1899, § 3206), it is provided by statute that a purchasing corporation shall acquire the right of eminent domain.

<sup>3</sup> *North Carolina, etc. R. Co. v. Carolina Central R. Co.*, 83 N. C. 489 (1880).

<sup>4</sup> *State v. Morgan*, 28 La. Ann. 482 (1876).

<sup>5</sup> *Little Rock, etc. R. Co. v. McGehee*, 41 Ark. 202 (1883).

<sup>6</sup> *Mahoney v. Spring Valley Water Co.*, 52 Cal. 159 (1877).

the legislative intention that it should pass is clearly apparent.<sup>1</sup>

In *Memphis, etc. R. Co. v. Commissioners*<sup>2</sup> Mr. Justice Matthews said: "Exemption from taxation must be construed to have been the personal privilege of the very corporation specifically referred to, and to have perished with that, unless the express and clear intention of the law requires the exemption to pass as a continuing franchise to a successor. This salutary rule of interpretation being founded upon an obvious public policy which regards such exemptions as in derogation of the sovereign authority and of common right, and therefore not to be extended beyond the exact and express requirement of the grants, is construed *strictissimi juris*."

In the application of this rule the words "rights," "franchises" and "privileges" have been held not to include an exemption from taxation;<sup>3</sup> while the contrary has been held with reference to the word "immunities."<sup>4</sup>

<sup>1</sup> *United States*: *Yazoo, etc. R. Co. v. Adams*, 180 U. S. 22 (1901), (21 Sup. Ct. Rep. 240); *Phoenix Fire, etc. Ins. Co. v. Tennessee*, 161 U. S. 174 (1896), (16 Sup. Ct. Rep. 471); *Wilmington, etc. R. Co. v. Alsbrook*, 146 U. S. 279 (1892), (13 Sup. Ct. Rep. 72); *Picard v. East Tennessee, etc. R. Co.*, 130 U. S. 637 (1889), (9 Sup. Ct. Rep. 640); *Chesapeake, etc. R. Co. v. Miller*, 114 U. S. 176 (1885), (5 Sup. Ct. Rep. 813); *Memphis, etc. R. Co. v. Commissioners*, 112 U. S. 609 (1884), (5 Sup. Ct. Rep. 299); *Railroad Co. v. Palmes*, 109 U. S. 244 (1883), (3 Sup. Ct. Rep. 193); *East Tennessee, etc. R. Co. v. Hamblin Co.*, 102 U. S. 273 (1880); *Railroad Co. v. Gaines*, 97 U. S. 697 (1878); *Morgan v. Louisiana*, 93 U. S. 217 (1876).

*Arkansas*: *Arkansas Midland R. Co. v. Berry*, 44 Ark. 17 (1884).

*Kentucky*: *Evansville, etc. R. Co. v. Commonwealth*, 9 Bush, 438 (1872);

*Commonwealth v. Nashville, etc. R. Co.*, 93 Ky. 430 (1892), (20 S. W. Rep. 383).

*Minnesota*: *Contra*, *St. Paul, etc. R. Co. v. Parcher*, 14 Minn. 297 (1869).

*Missouri*: *State v. Chicago, etc. R. Co.*, 89 Mo. 523 (1886), (14 S. W. Rep. 522).

*New Jersey*: *Assessors v. Morris, etc. R. Co.*, 49 N. J. L. 193 (1886), (7 Atl. Rep. 826).

*South Carolina*: *Contra*, *Hand v. Savannah, etc. R. Co.*, 17 S. C. 280 (1881).

*Tennessee*: *Wilson v. Gaines*, 9 Baxt. 546 (1877), (*affirmed* 103 U. S. 417), (1880).

See also *ante*, § 72: "*Exemptions from Taxation*" (consolidation).

<sup>2</sup> *Memphis, etc. R. Co. v. Commissioners*, 112 U. S. 609 (1884), (5 Sup. Ct. Rep. 299).

<sup>3</sup> The decisions of the Supreme

<sup>4</sup> *Phoenix Ins. Co. v. Tennessee*, 161 U. S. 177 (1896), (16 Sup. Ct. Rep. 471); *Louisville, etc. R. Co. v. Palmes*,

109 U. S. 252 (1883), (3 Sup. Ct. Rep. 193); *Trask v. Maguire*, 18 Wall. (U. S.) 391 (1873); *Nichols v. New*

§ 161. **Right to fix Rates of Fare. Chartered Rates.** — It has been held that the rates prescribed in the charter of a railroad company for transportation upon its railroad follow the property when sold, and attach to its operation by a purchasing

Court of the United States are irreconcilable.

In *Railroad Co. v. Gaines*, 97 U. S. 697 (1878), it was held that an exemption from taxation was not carried by the use of the words "rights, powers and privileges." In *Keokuk, etc. R. Co. v. Missouri*, 152 U. S. 301 (1894), (14 Sup. Ct. Rep. 592), it was doubted whether, under the name "franchises and privileges," an exemption would pass. In *Chesapeake, etc. R. Co. v. Miller*, 114 U. S. 176 (1885), (5 Sup. Ct. Rep. 813), it was decided that an exemption did not pass to the purchaser by the use of the words "franchises, rights and privileges." In *Morgan v. Louisiana*, 93 U. S. 217 (1876), it was held that the words "franchises, rights and privileges" did not, necessarily, include an exemption from taxation. See also *Phoenix, etc. Ins. Co. v. Tennessee*, 161 U. S. 182 (1896), (16 Sup. Ct. Rep. 471); *Wilmington, etc. R. Co. v. Alsbrook*, 146 U. S. 279 (1892), (13 Sup. Ct. Rep. 72). Also *Evansville, etc. R. Co. v. Commonwealth*, 9 Bush (Ky.), 438 (1892). On the other hand, in *Humphrey v. Pegues*, 16 Wall. (U. S.) 24 (1872), the Supreme Court held the words, "all the rights, powers and privileges," to include an exemption from taxation. Again in *Tennessee v. Whitworth*, 117 U. S. 139 (1886), (6 Sup. Ct. Rep. 649), it was said that the same words included the right of exemption. Chief Justice Waite, in his opinion, said (p. 146): "As has already been seen, the word 'privilege,' in its ordinary meaning, when

used in this connection, includes an exemption from taxation." See also *Atlantic, etc. R. Co. v. Allen*, 15 Fla. 637 (1876); *Louisville, etc. R. Co. v. Gaines*, 3 Fed. 266 (1880).

While the opinions cannot be reconciled the conclusion to be drawn from the later decisions of the Supreme Court of the United States is that there must be other language than the words "rights," "franchises" and "privileges" or other provisions sufficient to remove all doubt as to the legislative intention before the transfer of an exemption from taxation can take place.

*Gulf, etc. R. Co. v. Hewes*, 183 U. S. 66 (1901), (22 Sup. Ct. Rep. 26). *Phoenix Ins. Co. v. Tennessee*, 161 U. S. 182 (1896), (16 Sup. Ct. Rep. 471); *Wilmington, etc. R. Co. v. Alsbrook*, 146 U. S. 279 (1892), (13 Sup. Ct. Rep. 72); *Picard v. East Tennessee, etc. R. Co.*, 130 U. S. 637 (1889), (9 Sup. Ct. Rep. 640).

And any question as to the position of the Supreme Court has now been definitely settled by the very recent decision in *Rochester Railway Co. v. City of Rochester*, 205 U. S. 236 (1907), (27 Sup. Ct. Rep. 469), where Mr. Justice Moody said: "We think it now the rule, notwithstanding earlier decisions and *dicta* to the contrary, that a statute authorizing or directing the grant or transfer of the 'privileges' of a corporation, which enjoys immunity from taxation or regulation, should not be interpreted as including that immunity."

*Haven, etc. R. Co.*, 42 Conn. 103 (1875); *Commonwealth v. Owensboro, etc. R. Co.*, 81 Ky. 572 (1884);

*State v. Nashville, etc. R. Co.*, 12 Lea (Tenn.), 583 (1883).



company.<sup>1</sup> Thus in *Campbell v. Marietta, etc. R. Co.*,<sup>2</sup> the Supreme Court of Ohio said: "It must be inferred that the legislature intended the purchasing company to succeed to the powers and privileges of the vending company, and to none other. . . . The intrinsic as well as the market value of such property as a railroad largely depends upon the rates which may be charged for transportation thereon. Now, if the chartered rates follow the property, the contracting parties stand on perfect equality, but if the value, or, in other words, the inducement to contract, depends upon the chartered privilege of the purchaser, the equality is not preserved, and especially would different companies with different charters occupy unequal grounds as bidders for and purchasers of such property."

This decision is too broad. It may be that restrictions and limitations upon rates of fare presumptively attach as *burdens* to railroads when sold; but the converse of the proposition is not true that the chartered rates so follow the property as *privileges*. In the absence of an express statutory direction, the right to fix and determine rates of fare, or to charge a greater rate than permitted by general laws, does not accompany a railroad in its transfer to a purchaser.<sup>3</sup>

§ 162. **Obligations of Vendee Corporation in Respect of Public Duties of Vendor.** — As a general rule, a vendee corporation, in the operation of a purchased railroad, takes the place of the vendor company and must hold and operate the road subject to the conditions attaching to it in the hands of the vendor.<sup>4</sup>

<sup>1</sup> *Campbell v. Marietta, etc. R. Co.*, 23 Ohio St. 168 (1872); *Peters v. Railroad Co.*, 42 Ohio St. 275 (1884), (51 Am. Rep. 814).

<sup>2</sup> *Campbell v. Marietta, etc. R. Co.*, 23 Ohio St. 168 (1872).

<sup>3</sup> *St. Louis, etc. R. Co. v. Gill*, 156 U. S. 656 (1895), (15 Sup. Ct. Rep. 484).

In *Norfolk, etc. R. Co. v. Pendleton*, 156 U. S. 667 (1895), (15 Sup. Ct. Rep. 484), *affirming* 86 Va. 1004 (1890), (11 S. E. Rep. 1062), it was held that a right to fix tolls, conferred upon a vendor corporation, could not be claimed by a purchasing company

organized under general laws, and, therefore, subject to a statute fixing rates of fare. See also *Dow v. Beidelman*, 49 Ark. 325 (1887), (5 S. W. Rep. 297).

<sup>4</sup> *Daniels v. St. Louis, etc. R. Co.*, 62 Mo. 43 (1876).

Where a street railway company under its charter was bound to pay only a part of the cost of paving between and alongside its tracks, but did not act under this provision, and purchased the franchises of another company which was required to assume the entire cost of such pav-

While a vendor corporation may remain liable upon its public obligations notwithstanding a sale of its railroad, it seems clear that a vendee company, in purchasing and taking over a railroad and franchises, assumes and is bound to perform the accompanying obligations to the State.<sup>1</sup>

**§ 163. Vendee Corporation not liable upon Obligations of Vendor unless assumed or imposed by Law.** — A railroad company purchasing, in good faith and for value, the railroad and franchises of another company is not liable for the obligations of the latter company which are not liens upon the property.<sup>2</sup>

The reason for the rule and its qualifications are clearly

ing, it was held that the purchasing company was bound to act under the provisions of the charter of vendee company in the streets which it was authorized to occupy.

*Kent v. City of Binghampton*, 40 Misc. Rep. (N. Y.) 1 (1903), (81 N. Y. Supp. 198).

<sup>1</sup> A railroad company which purchases the property and franchises of any other company pursuant to a Michigan Statute (Act No. 10, Laws 1889), holds subject to all the duties and obligations prescribed by the general railroad laws of the State. *Thayer v. Flint, etc. R. Co.*, 93 Mich. 150 (1892), (53 N. W. Rep. 216).

A railroad company in selling its railroad cannot relieve the purchasing company from the performance of the duty imposed by statute to construct and maintain proper crossings over streams.

*Graham v. Chicago, etc. R. Co.*, 39 Ind. App. 249 (1906) (77 N. E. Rep. 1055).

<sup>2</sup> *Chesapeake, etc. R. Co. v. Griest*, 85 Ky. 625 (1887), (4 S. W. Rep. 323): "If the power to sell is given by the terms of the grant, the purchaser for value holds the property as if it had been an individual transaction. There is no reason for making a distinction, and the rule in individual transactions should apply as between corporations when the

power to sell and purchase is conferred by charter. While a dissolution of a corporation would entitle the creditors to enforce their demands in a court of equity, or where there is a consolidation to follow the assets of their debtor in the consolidated company, still, where there is a sale of the corporate property, it passes the title as to all, in the absence of some reservation in the charter protecting the rights of creditors."

*Burge v. St. Louis, etc. R. Co.*, 100 Mo. App. 460 (1903), (74 S. W. Rep. 7): "Under the section making valid the purchase by one railroad company of the line and property of another railroad company, no responsibility is imposed on the purchasing company for the obligations of its vendor. It is manifest that no statutory liability resulted from the mere purchase by the defendant, and, in the absence of averment and proof that it acquired and succeeded to the line and property of the selling company otherwise than as a purchaser in good faith, and for a valuable consideration, the transaction in no wise differs in legal effect from the purchase of any other property, realty or personalty, and no duty is devolved by law upon defendant to respond to the liabilities, whether in contract or in tort, of the selling corporation. A mere purchase in

stated by the Supreme Court of Arkansas in *Sappington v. Little Rock, etc. R. Co.*:<sup>1</sup> "It would not, as a matter of law, by virtue of its purchase of the property and franchises of the consolidated company, become bound to fulfil its personal obligations, as distinct from those which were liens upon the property. If the purchasing company knew of any equities against the other in favor of third persons, and bought subject to them, it might make a different case, and, perhaps, afford ground for some appropriate relief in chancery. But the obligation is not transferred *ipso facto* on the purchase. Otherwise no sale could ever be made of a railroad, from fear of coming into a *damnosa haereditas*."

But when a purchasing corporation, as a part of the consideration for the transfer, assumes the obligations of the vendor company, it is, manifestly, liable for all obligations whether founded in contract or tort.<sup>2</sup> It has been held, how-

good faith for value imposes no such obligation."

See also:

*United States*: *Rice v. Norfolk, etc. R. Co.* 153 Fed. 497 (1907).

*Arkansas*: *Sappington v. Little Rock, etc. R. Co.*, 37 Ark. 23 (1881).

*District of Columbia*: *Capital Traction Co. v. Offut*, 17 App. D. C. 292 (1900).

*Georgia*: *Southern R. Co. v. Puckett*, 121 Ga. 322 (1904), (48 S. E. Rep. 968); *Hawkins v. Central of Georgia R. Co.*, 119 Ga. 159 (1903) (46 S. E. Rep. 82).

*Illinois*: *Sartison v. Baltimore, etc. R. Co.*, 103 Ill. App. 507 (1902), *Compare Chicago, etc. R. Co. v. Chicago, etc. Coal Co.*, 79 Ill. 121 (1875).

*Kansas*: *Hukle v. Atchison, etc. R. Co.*, 71 Kan. 251 (1905), (80 Pac. Rep. 603).

*Missouri*: *Hagemann v. Southern El. R. Co.*, 202 Mo. 249 (1907), (100 S. W. Rep. 1081); *Lawson v. Illinois Southern R. Co.*, 116 Mo. App. 690 (1906), (94 S. W. Rep. 807); *Porter v. Illinois Southern R. Co.*, 116 Mo. App. 526 (1906), (92 S. W. Rep. 744);

*Kann v. Illinois Southern R. Co.*, 114 Mo. App. 162 (1905) (89 S. W. Rep. 346).

*South Carolina*: *Hammond v. Port Royal, etc. R. Co.*, 15 S. C. 10 (1881).

*Texas*: *Texas Central R. Co. v. Lyons* (Tex. Civ. App. 1896). (34 S. W. Rep. 362).

See also *ante*, § 123: "*Liability of Purchasing Corporation for Debts of Vendor Company*."

<sup>1</sup> *Sappington v. Little Rock, etc. R. Co.*, 37 Ark. 27 (1881).

<sup>2</sup> *Chesapeake, etc. R. Co. v. Griest*, 85 Ky. 619 (1887), (4 S. W. Rep. 323). See also *Union Trust Co. v. Illinois Mid. R. Co.*, 117 U. S. 434 (1886), (6 Sup. Ct. Rep. 809); *Hervey v. Illinois Mid. R. Co.*, 28 Fed. 169 (1884).

Where an insolvent railroad company sold its railroad to another company and furnished a guaranty that the property sold should be free from incumbrances, and that all claims against the vendor company should be discharged and the purchasing company held harmless therefrom, it was held that the guaranty was

ever, that before such a purchaser can be held liable for a tort committed by the vendor company in the operation of the road before the sale, the claim must be reduced to judgment in an action against the vendor.<sup>1</sup>

A provision in the charter of a railroad company authorizing it to purchase the railroad of another company and stipu-

personal to the purchasing company and was not enforceable in favor of the creditors of the vendor company.

*Randall v. Detroit, etc. R. Co.*, 134 Mich. 493 (1903), (96 N. W. Rep. 567).

Where the controlling stockholder of a corporation purchased a large amount of its stock and agreed with the remaining stockholders to give them for their shares stock in another corporation upon the conveyance thereto of the property and franchises of the former corporation, it was held that the latter corporation became responsible for the debts of the former and could not avoid liability upon the ground that the former was insolvent at the time of the sale.

*Camden Interstate R. Co. v. Lee*, (Ky. 1905), (84 S. W. Rep. 332).

A railroad company purchasing the railroad of another company without assuming its debts or obligations is not bound to honor a perpetual pass given by the vendor company in consideration of a grant of a right of way. Neither does a covenant to furnish such a pass run with the land.

*Dickey v. Railway Co.*, 122 Mo. 223 (1894), (26 S. W. Rep. 685).

<sup>1</sup> Where the purchasing corporation undertook to pay "all current indebtedness" incurred by the vendor in the operation, of its railroad, it was held that, even if the contract could be construed to render the purchaser liable for a tort committed by the vendor in the operation of its road, the claim must first be reduced to judgment in an action against the vendor. *Chesapeake, etc. R. Co.*

*v. Griest*, 85 Ky. 619 (1887), (4 S. W. Rep. 323).

Where a railroad company took over the property of another company subject to the payment of its indebtedness, it was held that as a claim for a tort could not be enforced against the purchaser until judgment therefor had been rendered against the vendor, the statute of limitations would only begin to run upon the rendition of such judgment.

*Louisville, etc. R. Co. v. Biddell*, 112 Ky. 494 (1902), (66 S. W. Rep. 34).

Under a statute authorizing the incorporation of railroad companies for the purpose of acquiring railroads authorized to be sold, and providing that, in case of purchase, the property should pass subject to all claims for damages, and also providing that the purchasing company might be made a party to pending suits, and that in case a judgment had been rendered against the vendor company execution might be levied against the property in the hands of the vendee, it was held:

(1) That a judgment for a tort against the vendee corporation was binding upon the vendor although it had not been made a party to the suit;

(2) That as the claim could not have been enforced against the purchasing company until judgment had been rendered against the vendor, the statute of limitations did not begin to run in favor of the purchaser until after judgment.

*Missouri, etc. R. Co. v. Warner*, 30 Tex. Civ. App. 280 (1902), (70 S. W. Rep. 365).

lating that the sale shall in no way affect the rights of the latter's creditors, protects unsecured creditors.<sup>1</sup> The word "indebtedness," as used in a statute providing that a purchasing railroad company shall assume the indebtedness of its vendor, embraces all debts and demands — claims founded both upon tort and contract.<sup>2</sup>

§ 164. **Status of Foreign Vendee Corporation.** — The legislature, in granting to a foreign corporation power to purchase a railroad and franchises within the State, may describe the terms and conditions upon which the purchase may be made and define the *status*, within the State, of the purchasing corporation.<sup>3</sup> And, in Georgia, it has been held that where permission to a foreign corporation to purchase a domestic railroad is made the subject of an original and direct grant by the legislature, the purchasing corporation, upon the purchase, "becomes *eo instanti* the offspring of the legislative will of the State."<sup>4</sup>

<sup>1</sup> *Montgomery, etc. R. Co. v. Branch*, 59 Ala. 139 (1877).

<sup>2</sup> *Chicago, etc. R. Co. v. Lundstrom*, 16 Neb. 254 (1884), (20 N. W. Rep. 198, 49 Am. Rep. 718).

Where a railroad company acquired the property of another railroad company subject to its bonded indebtedness and "all other indebtedness," it was held that the term "indebtedness" should be broadly construed as including claims for torts, as well as contractual liabilities.

*Louisville, etc. R. Co. v. Biddell*, 112 Ky. 494 (1902), (66 S. W. Rep. 34).

The following statutes provide, in substance, that the sale of a railroad as therein authorized shall not affect the rights of creditors: *Alabama*, Code 1896, § 1169 (as amended in 1899); *Arizona*, R. S. 1901, par. 864, § 1; *Arkansas*, S. & H. Dig. 1894, § 6188; *California*, Pomeroy's Code 1901, § 494; *Michigan*, Comp. Laws 1897, § 6328; *Nebraska*, Comp. Stat. 1901, §§ 1769, 4020, 4024, 4026; *New Jersey*, Laws 1900, ch. 46, p. 70; *Ohio*, Bates' Anno. Stat. (1787-1902),

§ 3300; *Wisconsin*, Stat. 1898, § 1833 (as amended in 1899).

<sup>3</sup> *State v. Chicago, etc. R. Co.*, 89 Mo. 523 (1886), (14 S. W. Rep. 522).

<sup>4</sup> *Angier v. East Tennessee, etc. R. Co.*, 74 Ga. 640 (1885). The Court said (p. 641): "The truth is to be ascertained whether the State intended merely to license a foreigner to exercise franchises and buy a charter she granted to another without assuming all the liabilities which the charter it bought required, or did she intend it to be a domestic corporation and under all the obligations of corporate citizenship? It is a question of intention; and it cannot be that she meant to make any such contract, with but one side to it, with anybody, natural or artificial, that might buy the charter she had granted. It must be that she intended, and expressed the intention in plain words, to substitute the purchaser for the entity she allowed to be purchased and to make the purchaser subject to her control within her own borders as fully as the seller of the charter had been before the sale."

## PART III

### CORPORATE LEASES

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#### ARTICLE I

#### CHAPTER XV

##### LEASES OF CORPORATE PROPERTY AND FRANCHISES

###### *I. Leases of Property of Private Corporations*

- § 165. Power to lease and take a Lease generally.
- § 166. Lease of Entire Property of Prosperous Corporation.
- § 167. Lease of Entire Property of Losing Corporation.
- § 168. Voidable Leases.
- § 169. Remedies of Objecting Stockholders.

###### *II. Leases of Property and Franchises of Quasi-public Corporations*

- § 170. Distinction between Leases of Private and *Quasi-public* Corporations.
- § 171. Leases of Indispensable Property of *Quasi-public* Corporation.
- § 172. Leases of Surplus Property.
- § 173. Leases of Franchises.
- § 174. Railroad Leases typical of Leases of *Quasi-public* Corporations.

###### *I. Leases of Property of Private Corporations*

§ 165. **Power to lease and take a Lease generally.** — Every corporation, as an incident to its existence, has power to acquire and dispose of property.<sup>1</sup> The greater power to sell and purchase includes the lesser power to lease and take a lease.<sup>2</sup>

<sup>1</sup> See *ante*, § 108: "*Power to purchase and sell generally.*"

<sup>2</sup> The decision in *Metropolitan Concert Co. v. Abbey*, 52 N. Y. Super.

Ct. 97 (1885), that authority granted to a corporation to sell real estate not required for its use did not authorize a lease thereof for a term of

A corporation has implied power to lease any portion of its property not required for the purposes of its business;<sup>1</sup> and may take a lease of property for the purpose of promoting its legitimate interests,<sup>2</sup> but not for a purpose entirely foreign thereto.<sup>3</sup>

years cannot be justified upon principle.

In *State v. New Orleans Warehouse Co.*, 109 La. 69 (1902) (33 So. Rep. 81) the Court said: "This corporation had the right to sell the property. We think, under the circumstances, that the power to sell carries with it the power to lease."

<sup>1</sup> *Indiana*: *Phillips v. Aurora Lodge*, 87 Ind. 505 (1882).

*Illinois*: *Keeley Brewing Co. v. Mason*, 116 Ill. App. 603 (1904).

*Massachusetts*: *Nye v. Storer*, 168 Mass. 53 (1897), (46 N. E. Rep. 402). In this case it was held that a corporation authorized by its charter to hold property might lease it so as to produce an income, for purposes entirely different from its own objects of incorporation.

*Missouri*: *Gilliland v. Chicago, etc., R. Co.*, 19 Mo. App. 411 (1885).

*New York*: *Denike v. New York, etc. Cement Co.*, 80 N. Y. 599 (1880); *Smith v. Berndt*, 1 N. Y. Supp. 108 (1888).

*Pennsylvania*: *Ardesco Oil Co. v. North American Oil, etc. Co.*, 66 Pa. St. 375 (1870).

*Tennessee*: *Coal Creek, etc. Co. v. Tennessee Coal, etc. Co.*, 106 Tenn. 651 (1901), (62 S. W. Rep. 162).

*England*: *Featherstonhaugh v. Lee Moor Porcelain Clay Co.*, L. R. 1 Eq. 318 (1865); *Simpson v. Westminster, etc. Hotel Co.*, 8 H. L. Cas. 712 (1860).

<sup>3</sup> *Occum Co. v. A. & W. Sprague Mfg. Co.*, 34 Conn. 529 (1868). In this case it was held that a corporation, chartered for a specific purpose, had no power to take a lease

Power to sell land includes power to lease with an option of purchase. *Re Female Orphan Asylum*, 17 L. T. (N. S.) 59 (1867).

If a corporation exceed its powers in the purchase of property it may nevertheless lease it and recover against a third person on a guaranty of the rent. *Nantasket Beach S. S. Co. v. Shea*, 182 Mass. 147 (1902), (65 N. E. Rep. 57).

A lease of the real estate used by a corporation to carry on its business does not constitute an abandonment of the purposes for which it was created.

*Starke v. J. M. Guffey Petroleum Co.*, 98 Tex. 542 (1905), (86 S. W. Rep. 1).

<sup>2</sup> *Abby v. Billups*, 35 Miss. 618 (1858), (72 Am. Dec. 143); *Crawford v. Longstreet*, 43 N. J. L. 325 (1881). In *Jacksonville, etc. R. Co. v. Hooper*, 160 U. S. 514 (1896), (16 Sup. Ct. Rep. 379), it was held that a railroad company might lease and maintain a hotel at its terminus. The Court said (p. 523): "Courts may be permitted, where there is no legislative prohibition shown, to put a favorable construction upon such exercise of power by a railroad company as is suitable to promote the success of the company, within its chartered powers, and to contribute to the comfort of those who travel thereon. To lease and maintain a summer hotel at the seaside terminus of a

property not needed for that purpose, with the intention and for the object of harassing another party by the use, under the forms of law, of the supposed rights thus obtained.

### § 166. Lease of Entire Property of Prosperous Corporation.

— While a lease of a portion of the property of a corporation — not impairing its capacity to do business — may be authorized by its directors or a majority of its stockholders, they have no authority to lease the entire property and business of the corporation. A lease by a prosperous corporation of all its property constitutes such a departure from the purpose for which it was organized that, in the absence of express statutory authority, it can be authorized only by the unanimous consent of its stockholders.<sup>1</sup>

railroad might, obviously, increase the business of the company and the comfort of its passengers, and be within the provisions of the statute of Florida above cited, whereby a railroad company is authorized 'to sell, lease, or buy any land or real estate necessary for its use,' and to 'erect and maintain all convenient buildings . . . for the accommodation and use of their passengers.' "

A foreign corporation has power to take a lease of property necessary for the transaction of its business. *Northern Transportation Co. v. Chicago*, 7 Biss. (U. S.) 45 (1874), *affirmed* 99 U. S. 635 (1878).

<sup>1</sup> In *Cass v. Manchester, etc. Co.*, 9 Fed. 642 (1881), Judge McKennan said: "The change proposed here is not organic, it is true, but it is thorough and fundamental, as it affects the administration of the company's affairs. It involves a withdrawal, from the control and management of the stockholders, of the entire property of the corporation for a period of at least five years; it will preclude, for a like period, the exercise annually by the stockholders of their judgment as to the particular character and method of conducting the business affairs of the corporation."

In *Small v. Minneapolis, etc. Co.*, 45 Minn. 267 (1891), (47 N. W. Rep. 797), the Court said: "We need not inquire how far, or under what circumstances, considerations of public

policy and of the general interests of the State may affect the right of a corporation to discontinue the business for which it was created, and to surrender to another corporation its property, and the conduct of such business. We do decide that such a surrender of the property, and, so far as possible, of the functions of a corporation, in order that, while it is still to continue in existence, its business can be carried on by another corporation, to which such transfer is made, would violate the rights of a non-assenting stockholder arising from a contract implied, if not expressed, in the creation of such an organization, and he would be entitled to have such acts restrained by injunction."

A manufacturing corporation made a lease of its plant and all its property to its president for a term of two and one-half years and it was *held* that the lease was void in that it suspended the business of the corporation for more than a year, and that it amounted to a surrender of the charter of the corporation, under a statute providing that a corporation, suspending its ordinary business for more than a year, should be deemed to have surrendered its charter. *Conro v. Port Henry Iron Co.*, 12 Barb. (N. Y.) 27 (1851). See also *Copeland v. Citizens Gaslight Co.*, 61 Barb. (N. Y.) 60 (1871).

Where a solvent corporation has



This limitation upon the power of the majority is entirely apart from any public duty the corporation may owe. It is founded upon the principle that every stockholder in a going concern has a right to insist that its affairs be administered by its own officers. He is entitled to participate in dictating the policy of the company and to receive a proportion of the

no express power to lease all its property, and it appears that in addition to its tangible property a large part of the subscriptions to its capital stock are unpaid, a lease of its entire property upon the ground that it is impossible to obtain capital to carry on the business, by vote of a majority of the stockholders, will be set aside at the suit of a dissenting stockholder.

*Parsons v. Tacoma Smelt. etc. Co.*, 25 Wash. 492 (1901), (65 Pac. Rep. 765).

It has been held, however, that when a corporation is expressly authorized by its charter to lease its property it may lease its entire property, although it is thereby disabled from continuing business. *Gubernator v. City of New Orleans*, 20 La. Ann. 106 (1868). In this case the Court said (p. 107): "The power to lease, granted by the charter, is unlimited and unrestricted; no distinction is made whether or not it be for the whole or a part of the property. How can we discriminate and distinguish when the law does not? *Ubi lex non distinguit, nec nos distinguere debemus*. Were we to attempt to draw a line of restriction and limitation, where would we trace it? It would be an arbitrary exercise of power on our part, reprobated by law."

And in *Starke v. J. M. Gaffey Petroleum Co.*, 98 Tex. 542 (1905), (86 S. W. Rep. 1, 4), it was said: "There is some conflict of authority upon the power of a private corporation, at common law, to lease for a term of years all of the property used

in the transaction of its business.

... These cases are based upon the broad proposition, that the power to lease does not exist in a private corporation, and therefore a lease made by such corporation is void, and amounts to an abandonment of the purposes for which it was incorporated. . . . The cases which hold adversely to our conclusion rest upon the proposition that the charter of a corporation is a contract between its stockholders to the effect that the funds put into the business should not be diverted to any other use or purpose without the consent of all. This is a sound principle . . . ; but from that proposition it is argued that the lease is a departure from the purposes for which the corporation was formed, which had in view the management of the business by the directors themselves, and is therefore a violation of the terms of the contract between the stockholders. The reasoning cannot apply as to corporations in this State, because when the contract was formed (that is, when the charter was filed) the law authorized the corporation to lease its property, and each stockholder entered into the contract (that is, into the corporation) with the understanding and knowledge of the fact that in doing so he empowered the directors to lease the property. The lease was not *ultra vires* but was made by virtue of the power expressly given by the statute. It was not a violation of the contract between the stockholders, but was made in pursuance of the terms of the contract — the charter."

profits of the enterprise rather than a share of a fixed rental. He cannot be compelled to accept an annuity in lieu of his share in the profits.

§ 167. **Lease of Entire Property of Losing Corporation.** — When a corporation is in a position where it cannot further profitably carry on its business and is a losing concern, a majority of its stockholders, for the purpose of protecting the whole body from further loss and as a method of winding up the affairs of the corporation, may authorize the lease of its entire property and business to another corporation or person, provision being made for creditors.<sup>1</sup> But a lease — which must necessarily occasion delay in winding up the affairs of a corporation and in distributing its assets — can only be justified, under such circumstances, when it appears to be the best method of realizing upon the assets of the company. Its term must be fixed with reference to the fact that it is executed only as a method of winding up the affairs of the corporation within a reasonable time. A lease for a long term of years would be invalid without the unanimous consent of the stockholders.<sup>2</sup>

<sup>1</sup> *Denike v. New York, etc. Cement Co.*, 80 N. Y. 608 (1880): "The lessee by the terms of the lease was to carry on the business of manufacturing and selling cement, so that the brand of the company would be kept before the public. I do not understand that this company could not lawfully temporarily lease its property to some person who would carry on its business when it could not profitably do so."

A manufacturing corporation, for the purpose of protecting its stockholders from further loss, may discontinue the business and sell or lease its property. *Skinner v. Smith*, 134 N. Y. 240 (1892), (31 N. E. Rep. 911).

A private corporation has the power to rent its property for the purpose of raising money necessary to pay a pressing indebtedness which cannot otherwise be met, when it appears that such a course is necessary for its protection, and is entered into in good faith, and especially when it further appears that the

arrangement is temporary and there is no purpose on the part of the lessor to abandon its corporate powers.

*Plant v. Macon Oil, etc. Co.*, 103 Ga. 666 (1898), (30 S. E. Rep. 567).

The directors of a manufacturing company which has been unsuccessfully carrying on business and whose financial standing is impaired, may, with the consent of a majority of the stockholders, lease its entire plant and business to another corporation for ten years with the privilege of purchase, the lease being the best means of preventing insolvency and the transaction being in good faith. *Bartholomew v. Derby Rubber Co.*, 69 Conn. 521 (1897), (38 Atl. Rep. 45, 61 Am. St. Rep. 57).

See *Shawnee Compress Co. v. Anderson*, decided by U. S. Supreme Court, April, 1908, affirming 17 Okl. 231 (1906). And see *ante*, § 111: "*Sale of Entire Property of Losing Corporation by Majority Vote.*"

<sup>2</sup> In an English case, however,

It has been held that even a long term lease might be executed if provision were made for paying dissenting stockholders, at their option, the cash value of their shares.<sup>1</sup> Unless so provided by statute, however, the scheme is open to the objection that it gives a dissenting stockholder a *theoretical* distributive share instead of the *actual* share of the assets to which he is entitled.<sup>2</sup> If such a method be provided, it can only be followed when it is clear that the corporation is a losing concern. It can never be adopted for the purpose of forcing a stockholder in a prosperous company either to sell out or to consent to a lease.

§ 168. **Voidable Leases.** — The directors of a corporation are its trustees. They cannot deal with corporate property for their personal benefit. A lease of the property of a corporation to another corporation in which a director is interested is voidable at the option of either corporation.<sup>3</sup> When the cor-

where wide powers were given by the clauses of the charter of a porcelain company to a two-thirds vote of the stockholders, it was held that, after a period of nine years of unsuccessful working, a majority of two-thirds of the shareholders in general meeting were empowered, under such clauses, to authorize the directors to make a valid mining lease for twenty-one years of the whole of the works and buildings of the company. *Semble*, the clauses would not authorize the like majority to engage the company in a new enterprise wholly unconnected with their original purpose. *Featherstonhaugh v. Lee Moor Porcelain Clay Co.*, L. R. 1 Eq. 318 (1865).

<sup>1</sup> In *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 415 (1871), Chancellor Zabriskie said: "If I am right in the conclusion arrived at above, that the majority of corporators under a charter, which specifies no definite time for its continuance, have a right to abandon the undertaking, and dispose of and divide the property, the proceeding in this case is valid as against the complainants as a lawful way of accomplishing that end as to

them. Two-thirds of these corporators have determined that they do not desire to go on with these enterprises, under the charters, and that they wish to abandon them, and are willing to accept as their share of the corporate property a yearly rent or annuity secured by a provision like that contained in this proposed lease. Some stockholders are not willing; and although the majority can effect the abandonment, they cannot compel the dissentients to accept like compensation for their stock; it might be compelling them to embark in a new enterprise. Provision is, therefore, made to pay or return to them the full value of their share of the whole property of the corporation. This is all they would have if the works were sold out. The provision is a most equitable one, and without it the transaction, even if valid and legal, would not be equitable and just."

<sup>2</sup> See *ante*, § 121: "*Appraisal of Stock of Dissenting Stockholders.*"

<sup>3</sup> Where a trustee of a corporation, whose presence is necessary to make a majority for the transaction of cor-

poration fails to act a court of equity may intervene at the instance of any stockholder.

The majority of the stockholders of a corporation stand in a similar fiduciary relation towards the minority. They can authorize the lease of corporate property to another corporation, controlled by themselves, only when they act in the utmost good faith towards minority stockholders. In *Meeker v. Winthrop Iron Co.*<sup>1</sup> Judge Baxter in declaring void, as a fraud upon minority stockholders, a lease of a mining property authorized by a majority of the stockholders of a corporation to another corporation of which they likewise held control, said: "The ownership of a majority of the capital stock of a corporation invests the holders thereof with many and valuable incidental rights. They may legally control the company's business, prescribe its general policy, make themselves its agents, and take reasonable compensation for their services. But, in thus assuming control, they also take upon themselves the correlative duty of diligence and good faith. They cannot lawfully manipulate the company's business in their own interests to the injury of other corporators."<sup>2</sup>

porate business, is interested in another corporation to which the board vote to lease the entire property of the corporation, the lease, executed in pursuance of such authority, is voidable upon the complaint of any stockholder. *Parsons v. Tacoma Smelting, etc. Co.*, 25 Wash. 492 (1901), (65 Pac. Rep. 765).

A lease by an officer of a corporation of property to the corporation may be binding upon the company when made in good faith and ratified by it by taking possession and paying rent for a time according to the terms of the lease. *Louisville, etc. R. Co. v. Carson*, 151 Ill. 444 (1894), (38 N. E. Rep. 140). See also *post*, § 248: "*Voidable Railroad Leases.*"

<sup>1</sup> *Meeker v. Winthrop Iron Co.*, 17 Fed. 50 (1883). See also cases cited in notes to *post*, § 248: "*Voidable Railroad Leases*" and in notes to § 114, *ante*.

<sup>2</sup> Where one corporation purchases a controlling interest in the stock of another and thereby elects directors and secures a lease of the property of such corporation on its own terms and conditions, it is held that such lease will be set aside at the suit of minority stockholders of the latter company, even though obtained without actual fraud.

*Glengary Consol. Min. Co. v. Boehmer*, 28 Colo. 1 (1900), (62 Pac. 839).

In *Shaw v. Davis*, 78 Md. 308 (1894), (28 Atl. Rep. 619, 23 L. R. A. 294), however, where a minority stockholder filed a bill against the majority stockholders and officers of a corporation praying an injunction restraining the execution of a lease of the property of such corporation to another corporation in which such majority likewise held controlling interests, the Court said

§ 169. **Remedies of Objecting Stockholders.** — Any stockholder in a prosperous corporation who objects to a lease of the entire property and business of his corporation is entitled to an injunction to restrain its execution.<sup>1</sup> But an injunction will not be granted where a lease of only a part of the property of the corporation, insufficient to interfere with the continued prosecution of its business, is contemplated.<sup>2</sup>

Courts of equity, at the instance of stockholders, will also issue injunctions to restrain the execution of leases authorized by directors or majority stockholders in violation of their fiduciary obligations.<sup>3</sup>

(p. 318): "The fact that the same persons hold the majority of the stock in both companies does not of itself enlarge the court's jurisdiction; the act complained of furnishes the test of jurisdiction, and it must be *ultra vires*, fraudulent or illegal; nothing short of this will suffice. This is true even in a case where directors and not stockholders do the act complained of. And for stronger and more obvious reasons it is also true in a case where stockholders themselves act directly. They are not trustees or *quasi-trustees* for each other."

But this last statement is contrary to the weight of authority. See *post*, § 300: "*Trust Relation of Controlling Corporation to Minority Stockholders*" and cases cited.

A domestic corporation acquired a controlling interest in a foreign corporation and took a lease of its property, promising to pay rent in the form of dividends to the stockholders of the lessor corporation and, after various transfers of this controlling stock interest, it came into the hands of a corporation which proposed to vote such controlling stock to rescind the agreement and avoid paying the dividend. It was held that a minority stockholder of the lessor corporation was entitled to restrain such action, as being so detri-

mental to the interests of the lessor corporation as to lead to the inference that the interests of the majority stockholders were opposed to those of the corporation as well as to those of the minority, and also because such action was so oppressive to the minority as to amount to fraud.

*McLeary v. Erie Tel., etc. Co.*, 38 Misc. (N. Y.) 3 (1902), (76 N. Y. Supp. 712).

<sup>1</sup> A stockholder in a manufacturing corporation may enjoin a lease, authorized by a majority of the stockholders, of all its property and business for twenty-five years at a rental equal to one-half the profits derived from the business. *Small v. Minneapolis, etc. Co.*, 45 Minn. 264 (1891), (47 N. W. Rep. 797). Also *Copeland v. Citizens Gaslight Co.*, 61 Barb. (N. Y.) 60 (1871).

That a lease, although unlawful, does not give a portion of the stockholders a standing in equity to ask for the dissolution of the corporation, see *Denike v. New York, etc. Cement Co.*, 80 N. Y. 599 (1880). See also *ante*, § 114: "*Remedies of Dissenting Stockholders in Case of Invalid or Unfair Sales. Voidable Sales.*"

<sup>2</sup> *Small v. Minneapolis, etc. Co.*, 57 Hun (N. Y.), 587 (1890), (10 N. Y. Supp. 456).

<sup>3</sup> *Meeker v. Winthrop Iron Co.*, 17 Fed. 48 (1883); *Parsons v. Tacoma*

## II. *Leases of Property and Franchises of Quasi-public Corporations*

§ 170. **Distinction between Leases of Private and Quasi-public Corporations.** — Leases of *quasi*-public corporations vary from those executed by private corporations, owing no public duties, in their need of the approval of the State, in the formalities attending their execution, and in their essential nature. A lease by a private corporation is generally an incident to its business, runs for a limited term and is analogous to a lease by a natural person. A lease by a *quasi*-public corporation of its property and franchises requires legislative sanction, must follow the conditions of the legislative grant, and is, when executed for the customary periods — ninety-nine or nine hundred and ninety-nine years — substantially a *sale in consideration of an annuity*. While the relation of the parties is that of landlord and tenant, and the lease may be the subject of forfeiture, for practical purposes based upon present and future control of the franchises and property, the lessee stands in the position of owner.

§ 171. **Leases of Indispensable Property of Quasi-public Corporation.** — Upon principles already considered, property necessary for the performance of the public duties of a *quasi*-public corporation cannot be leased without statutory authority.<sup>1</sup> The test of indispensability applicable in the case of corporate sales applies in the case of corporate leases.<sup>2</sup>

§ 172. **Leases of Surplus Property.** — The greater power to sell and absolutely convey the surplus property of a *quasi*-public corporation includes the lesser power to lease it.<sup>3</sup>

In the absence of a statutory prohibition, such a corporation may lease its property, real and personal, not necessary to carry on the business for which it was chartered nor to fulfil its public obligations, in the same manner and upon the same

Smelting, etc. Co. 25 Wash. 492 (1901), (65 Pac. Rep. 765). See also cases cited in notes to § 248, *post*: "*Voidable Railroad Leases*."

<sup>1</sup> See *ante*, § 127: "*Indispensable Property cannot be alienated or taken*

*on Execution without Statutory Authority*."

<sup>2</sup> See *ante*, § 128: "*Test of Indispensability*."

<sup>3</sup> See *ante*, § 129: "*Sales of Surplus Property*."

conditions as a natural person.<sup>1</sup> Thus, for example, a railroad company may lease its outlying lands and any rolling stock or other personal property not required in the use and operation of its railroad.<sup>2</sup> And a ferry company may let its boats when not needed in its business.<sup>3</sup>

<sup>1</sup> Statutes regulating the method and formalities by which quasi-public corporations may lease their property and franchises do not apply to ordinary leases of property not necessary for the proper discharge of corporate duties. *Coal Creek, etc. Co. v. Tennessee, etc. Co.*, 106 Tenn. 651 (1901), (62 S. W. Rep. 162).

<sup>2</sup> In *Hartford Ins. Co. v. Chicago, etc. R. Co.*, 175 U. S. 99 (1899), (20 Sup. Ct. Rep. 33), Mr. Justice Gray said: "A railroad corporation holds its station grounds, railroad tracks and right of way for the public use for which it is incorporated, yet as its private property, and to be occupied by itself or by others, in the manner which it may consider best fitted to promote, or not to interfere with, the public use. It may, in its discretion, permit them to be occupied by others with structures convenient for the receiving and delivering of freight upon its railroad, so long as a free and safe passage is left for the carriage of freight and passengers. . . The case is wholly different from those cited by the plaintiffs, in which a lease by a railroad corporation, transferring its entire property and franchises to another corporation, and thus undertaking to disable itself from performing all the duties to the public imposed upon it by its charter, has been held to be *ultra vires*, and therefore void."

And in *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 51 Fed. 321 (1892), Judge Sanborn said: "The result is that it is not beyond the powers of a corporation authorized to construct, maintain and operate a railroad and its appurtenances to let

by contract to a like corporation its surplus rolling stock, or the surplus use of its terminal tracks, depots, and bridges, which it has necessarily acquired for the purpose of its incorporation; provided, always, that such contract in no way disables it from the full performance of its obligations and duties to the State and the public."

In *Attorney-General v. Great Eastern R. Co.*, L. R. 11 Ch. 449 (1879), it was held that the letting for hire by one railroad company to another whose line was connected with its own, and which could only be worked profitably in connection with it, of parts of its surplus rolling stock, was not *ultra vires*.

A railroad corporation may lease a portion of its property, not required in its business, to a public warehouse company.

*State v. New Orleans Warehouse Co.*, 109 La. 64 (1902), (33 So. Rep. 81).

A railroad company has a right to lease a portion of its right of way for the purpose of securing freight from the lessee. *Detroit v. Little*, 146 Mich. 373 (1906), (109 N. W. Rep. 671). See also *Michigan Central R. Co. v. Bullard*, 120 Mich. 416 (1899), (79 N. W. Rep. 635).

A railroad company, authorized to construct and operate a telegraph line as well as a railroad, has no power to lease its telegraph line without statutory authorization. Its duties are the same with respect to the telegraph line as to the railroad. *Atlantic, etc. Tel. Co. v. Union Pacific R. Co.*, 1 McCrary (U. S.), 541 (1880), 1 Fed. 745.

<sup>3</sup> In *Brown v. Winnisimmet Co.*, 11 Allen (Mass.) 326 (1865), the Court,

Analogous to this principle in practical results, although based upon essentially different grounds — in that a joint use is distinguishable from a lease — is the principle that a railroad company may grant to another corporation the *surplus use* of its tracks.<sup>1</sup>

§ 173. **Leases of Franchises.** — The principles of law governing leases of franchises have already been considered at length in connection with the subject of the sale of franchises.<sup>2</sup>

§ 174. **Railroad Leases typical of Leases of Quasi-public Corporations.** — As indicated in the preliminary part of this treatise, railroad companies have been granted, and have exercised, the power of leasing their property and franchise to a far greater extent than other corporations of a similar nature. Legal principles relating to leases of *quasi*-public corporations have been established, almost without exception, in cases involving railroad leases.

While, therefore, in the further consideration of the subject special reference will be made to leases of railroads, it must be borne in mind that the principles exemplified are of general application and apply alike to every *quasi*-public corporation — to turnpike, canal, telegraph, telephone, electric light, gas, water and other public utility companies.<sup>3</sup>

after referring to the powers of ferry companies and to their right to own extra boats, said (p. 333): "It is not necessary that such extra or additional steamboats should be kept unemployed when not required for the business of the ferry, but . . . it is competent for the defendants to use them or to let them to others to be used in carrying on any legitimate business."

In *Forrest v. Manchester, etc. R. Co.*, 30 Beav. 47 (1861), the Master of the Rolls said: "What are they to do with those steamboats at other times when unemployed at the ferry? Are they to keep them idle? I am of opinion that they are not; and that if the capital of the company is really embarked for the purpose of the ferry and not for the purpose of excursions, when the steamboats are not required

to carry over the persons who wish to use the ferry, they are at liberty to use them as they think fit, for the profit of the company, and either to let them out to private parties for excursions, or to carry excursion parties themselves."

<sup>1</sup> *Chicago, etc. R. Co. v. Union Pac. R. Co.*, 47 Fed. 23 (1891), *affirmed sub nom. Union Pac. R. Co. v. Chicago, etc. R. Co.*, 51 Fed. 321 (1892), 163 U. S. 564 (1895), (16 Sup. Ct. Rep. 1173). See *post*, ch. XXIV.: "*Track-age Contracts*."

<sup>2</sup> See *ante*, ch. XII.: "*Sales of Corporate Franchises*."

<sup>3</sup> The following cases relate to leases of *quasi*-public corporations other than railroad companies.

*Gas and Electric Light Companies: Jersey City Gas Co. v. United Gas*



## ARTICLE II

## LEASES OF RAILROADS (INCLUDING TRACKAGE CONTRACTS)

## CHAPTER XVI

## NATURE AND AUTHORIZATION OF CONTRACT OF LEASE

I. *Nature of Lease of Railroad*

- § 175. What constitutes a Lease of a Railroad.  
 § 176. Distinction between Relation of Lessor and Lessee and other Intercorporate Relations.

II. *Legislative Authority for Lease of Railroad*

- § 177. Lease of Railroad invalid without Legislative Authority.  
 § 178. Necessity for Legislative Authority to take a Lease.  
 § 179. Legislative Ratification of Unauthorized Lease.  
 § 180. What Railroads may be leased. Statutory Provisions.  
 § 181. Rule of Construction of Statutes.  
 § 182. Construction of Statutes. — (A) Provisions authorizing Leases.  
 § 183. Construction of Statutes. — (B) Provisions not authorizing Leases.  
 § 184. Construction of Statutes. — (C) Power to lease Unfinished Road.  
 § 185. Construction of Statutes. — (D) Leases of Connecting Lines.  
 § 186. Constitutional and Statutory Prohibitions of Leases of Competing or Parallel Lines.  
 § 187. Long-term Leases not prohibited by Statutes against Perpetuities.

I. *Nature of Lease of Railroad*

§175. **What constitutes a Lease of a Railroad.** — A railroad lease is a conveyance by a railroad company, for rent reserved,

Imp. Co., 46 Fed. 264 (1891); Visalia Gas, etc. Co. v. Sims, 104 Cal. 326 (1894), (43 Am. St. Rep. 105, 37 Pac. Rep. 1042); Chicago Gas Light, etc. Co. v. People's Gas Light, etc. Co., 121 Ill. 530 (1887), (13 N. E. Rep. 169, 2 Am. St. Rep. 124); Brunswick Gas Light Co. v. United Gas, etc. Co., 85 Me. 532 (1893), (35 Am. St. Rep. 385, 43 Am. & Eng. Corp. Cas. 459, 27 Atl.

Rep. 525); Bath Gas Light Co. v. Claffy, 151 N. Y. 24 (1896), (45 N. E. Rep. 390, 36 L. R. A. 664).

*Telegraph Companies:* Philadelphia v. Western Union Tel. Co., 11 Phila. 327 (1876); Atlantic, etc. Tel. Co. v. Union Pacific R. Co., 1 Fed. 745 (1880), 1 McCrary (U. S.), 541; Western Union Tel. Co. v. Union Pacific R. Co., 3 Fed. 1 (1880), 1 McCrary (U.

of its railroad for any term which leaves a reversionary interest.<sup>1</sup> It necessarily involves a transfer of an estate in the railroad property and of the franchises attaching thereto. It generally involves a transfer of the railroad and all the franchises of the vendor corporation for a long term of years — often equivalent to a grant of the fee in consideration of stated payments.<sup>2</sup>

S.), 418; *Central Branch Union Pacific R. Co. v. Western Union Tel. Co.*, 2 Fed. 417 (1881), 1 McCrary (U. S.), 551; *Reiff v. Western Union Tel. Co.*, 49 N. Y. Super. Ct. 441 (1883).

<sup>1</sup> A grant and demise by one railroad corporation to another of all its property, real and personal, and all its privileges and franchises in perpetuity, has been held equivalent to an absolute conveyance. *Chicago, etc. R. Co. v. Boyd*, 118 Ill. 73 (1886), (7 N. E. Rep. 487).

See also *Hazard v. Vermont, etc. R. Co.*, 17 Fed. 753 (1883); *Vermont, etc. R. Co. v. Vermont Cent. R. Co.*, 34 Vt. 1 (1861); *Town of Westbrook's Appeal from Commissioners*, 57 Conn. 95 (1889), (17 Atl. Rep. 368). Compare *State v. Housatonic R. Co.*, 48 Conn. 44 (1880).

While this conclusion may be correct where no right of reëntry is reserved in a lease, it is not well founded, as a matter of law, where there is clause of reëntry. A reservation of the right to reënter together with that of rent, constitute a reversionary interest, — the essential feature of a lease as distinguished from an absolute conveyance.

A conveyance of a right of way to a railroad company contained this condition: "In case the second party shall sell the above-mentioned right of way to any other company, the party of the first part shall be entitled to receive one-half of the purchase money." The railroad company leased its entire railroad and property for 999 years. It was held that the lease was not a sale within the meaning of the condition.

*Morrison v. St. Paul, etc. R. Co.*, 63 Minn. 75 (1895), (65 N. W. Rep. 141, 30 L. R. A. 546).

<sup>2</sup> *Moorshead v. United Rys. Co.*, 119 Mo. App. 541 (1906), (96 S. W. Rep. 261), *affirmed* 203 Mo. 121 (1907), (100 S. W. Rep. 611): "Does the contract possess the elements of a lease? In this connection it is proper to remark, in the first place, that goods, chattels, and franchises may be leased as well as lands and tenements. The statutes of the State gave the United Railways Company the right to lease its franchises, railway lines and every other property, and by the same statute the Transit Company had the right to acquire every character of property belonging to the United Railways Company, including its franchises. We need not be troubled about the power of the two companies to enter into a lease covering all the properties mentioned in the instrument. The contract mentioned divested the United Railways Company of the possession and use of the properties during the period named (40 years) in consideration of a specific rent to be paid by the Transit Company, and other duties in the nature of rent, to be performed by the latter;" provided further for the reversion of the property to the grantor, the United Railways Company, at the end of the term, and for reëntry if the Transit Company defaulted in the performance of its covenants during the term. Those ingredients in the agreement suffice to constitute a lease."

A vote by a railroad company to agree with another company to take

The elements essential to the existence of a valid railroad lease are as follows:

a lease of a railroad to be constructed by the latter and to pay as rent a stipulated percentage upon its cost, and a similar vote of the latter corporation to lease its railroad to the former upon these terms, are merely preliminary and do not constitute an actual lease. *Peters v. Boston, etc. R. Co.*, 114 Mass. 127 (1873).

The receiver of a railroad, the earnings of which were less than the expense of operation, entered into a contract with a company owning a connecting line by which the latter agreed to operate the road, keeping the accounts in the receiver's name and charging against the road only the cost of operation and necessary repairs. It was held that the contract was not a lease, but one under which the latter company operated the road as agent of the receiver. *South Carolina, etc. R. Co. v. Carolina, etc. R. Co.*, 93 Fed. 543 (1899).

A railroad company agreed to sell to another company and the latter agreed to buy, part of its road at a fixed price. The contract, however, recited that the vendor could not, at the time, make a clear title and it was, therefore, stipulated that, in the mean time, the vendor should lease the road to the purchaser. The provisions in relation to the sale and to the lease were kept distinct throughout the contract. It was held that, prior to the time when title could be transferred, the relations of the corporations were those of lessor and lessee, and that, even if the contract of sale was *ultra vires*, the lease was valid. *United States Trust Co. v. Mercantile Co.*, 88 Fed. 140 (1898).

A written agreement by which one railroad company grants to another the right, for a term of years, to maintain its track across the right of way of the former, upon payment of a

nominal rental, is a lease, the covenants of which run with the land. *Louisville, etc. R. Co. v. Illinois, etc. R. Co.*, 174 Ill. 448 (1898), (51 N. E. Rep. 824).

The fact that the road of one railroad company was operated by the receiver of another company who paid therefor a part of the gross receipts arising from its operation established the relationship of lessor and lessee rather than a partnership.

*Houston etc. R. Co. v. McFadden*, 91 Tex. 194 (1897), (42 S. W. Rep. 593).

A contract, by which a telegraph company grants to another the privilege of stringing wires on its telegraph poles, is not a lease of the corporation's property, within the meaning of a statute providing that leases of corporate property can be made only when sanctioned by holders of three-fifths of the stock. *Farnsworth v. Western Union Tel. Co.*, 53 Hun (N. Y.), 636 (1889), (6 N. Y. Supp. 735).

As to whether a particular agreement was a "contract" or lease, see *Archer v. Terre Haute, etc. R. Co.*, 102 Ill. 492 (1882), (7 Am. & Eng. R. Cas. 255). See also *Wiggins Ferry Co. v. Ohio, etc. R. Co.*, 142 U. S. 396 (1891), (12 Sup. Ct. Rep. 188); *South Carolina, etc. R. Co. v. Augusta, etc. R. Co.*, 107 Ga. 164 (1899), (E. Rep. 33 S. 36).

In *Michigan Central R. Co. v. Pere Marquette R. Co.*, 128 Mich. 333 (1901), (87 N. W. Rep. 271) the Court said: "The rights of the parties must, therefore, be determined by the contract which they voluntarily made. The situation was this: The Saginaw Valley Company desired to avoid the construction and maintenance of a separate road for a distance of five miles, and as

(1) A grant of authority by the State to both lessor and lessee corporations.

(2) The assent of the stockholders of both corporations.

(3) A written instrument stating the term and rent.

(4) Its formal execution.

§ 176. **Distinction between Relation of Lessor and Lessee and other Intercorporate Relations.** — The distinction between a contract of lease entered into by railroad corporations and their consolidation has already been pointed out.<sup>1</sup> The difference between the relation of lessor and lessee and other intercorporate relations is, generally, obvious.

Contracts for the joint use of railroad property are, however, analogous to leases, and some difficulty has arisen in distinguishing between them. The point of difference is that a lease conveys an estate in, and the possession of, the property constituting its subject-matter, while a trackage contract or terminal privilege carries with it no interest in the property and no right to its exclusive possession.<sup>2</sup>

## II. *Legislative Authority for Lease of Railroad*

§ 177. **Lease of Railroad invalid without Legislative Authority.** — Upon principles elsewhere considered, a *quasi*-public corporation cannot transfer, absolutely or for a limited period, its franchises, or the property necessary for the performance of its public duties, without legislative authority.<sup>3</sup> A lease of

well the construction of separate depots and the purchase of depot grounds. It must do this or make a contract with the Jackson . . . Company. The former could not compel the use of the latter's road and depots. The latter was willing to grant a permanent use of its road to the former for certain considerations. These were agreed to. The Jackson road did not sell to the Saginaw Valley road any of its real estate, but granted only a permanent lease. To hold otherwise would be doing violence to the meaning of the plainest terms. The Saginaw Valley road was under no obligation to continue

the arrangement, but might at any time construct its own road; and there is nothing in the contract to prevent it. The relation between the parties was simply that of lessor and lessee, and not that of tenants in common of the right of way. The right conveyed was that of user, and not that of ownership."

<sup>1</sup> See *ante*, § 14: "*Distinction between Consolidation and Lease.*"

<sup>2</sup> See *post*, § 255: "*Nature of a Trackage Contract.*"

<sup>3</sup> See *ante*, §§ 17-18: "*Necessity for Legislative Authority*" (consolidation); *ante*, §§ 135-139: "*Legislative Authority for Sale of Franchises.*"

a railroad, in the absence of a statute authorizing it, is *ultra vires* and against public policy.<sup>1</sup>

<sup>1</sup> I. *Cases holding Unauthorized Railroad Lease invalid because Ultra Vires.*

*United States:* St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co., 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953); Central Transp. Co. v. Pullman Car Co., 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); Pittsburgh, etc. R. Co. v. Keokuk Bridge Co., 131 U. S. 371 (1889), (9 Sup. Ct. Rep. 770); Oregon R., etc. Co. v. Oregonian Co., 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409); Pennsylvania R. Co. v. St. Louis, etc. R. Co., 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094); Thomas v. Railroad Co., 101 U. S. 71 (1879), (leading case); Hamilton v. Savannah, etc. R. Co., 49 Fed. 412 (1892).

*Alabama:* Memphis, etc. R. Co. v. Grayson, 88 Ala. 572 (1889), (7 So. Rep. 122, 16 Am. St. Rep. 69, 43 Am. & Eng. R. Cas. 681).

*Indiana:* Commissioners of Tippecanoe Co. v. Lafayette, etc. R. Co., 50 Ind. 85 (1875).

*Massachusetts:* Middlesex R. Co. v. Boston, etc. R. Co., 115 Mass. 347 (1874).

*Montana:* State v. Montana R. Co., 21 Mont. 221 (1898), (53 Pac. Rep. 623).

*Nebraska:* State v. Atchison, etc. R. Co., 24 Neb. 143 (1888), (8 Am. St. Rep. 164, 38 N. W. Rep. 43).

*New Hampshire:* Dow v. Northern R. Co., 67 N. H. 1 (1886), (36 Atl. Rep. 510).

*New Jersey:* Black v. Delaware, etc. Canal Co., 24 N. J. Eq. 454 (1873).

*New York:* Abbott v. Johnstown, etc. Horse R. Co., 80 N. Y. 27 (1880), (36 Am. Rep. 572); Troy, etc. R. Co. v. Kerr, 17 Barb. (N. Y.) 581 (1854); Gere v. New York Central, etc. R. Co., 19 Abb. N. C. 193 (1885).

*England:* East Anglian R. Co. v. Eastern Counties R. Co., 11 C. B. (o. s.) 775 (1851); Simpson v. Denison, 10 Hare, 51 (1852), (16 Jur. 828).

II. *Cases holding Unauthorized Railroad Lease invalid because against Public Policy.*

*United States:* Thomas v. Railroad Co., 101 U. S. 71 (1879); Earle v. Seattle, etc. R. Co., 56 Fed. 909 (1893). Compare, however, Pittsburgh, etc. R. Co. v. Columbus, etc. R. Co., 8 Biss. 456 (1879).

*Georgia:* Singleton v. Southwestern R. Co., 70 Ga. 464 (1883), (48 Am. Dec. 574).

*Illinois:* Wabash, etc. R. Co. v. Payson, 106 Ill. 534 (1883), 46 Am. Rep. 705).

*Kentucky:* McCabe's Admx. v. Maysville, etc. R. Co., 112 Ky. 861 (1902), (66 S. W. Rep. 1054).

*Massachusetts:* Braslin v. Somerville Horse R. Co., 145 Mass. 64 (1887), (13 N. E. Rep. 65): "The general rule is familiar, that neither a steam nor a street railway corporation can make a valid transfer, either by way of absolute deed, mortgage or lease, of its franchise, or of its railroad and bulk of its property, or relieve itself of the burdens imposed upon it by law, or by its charter, without the consent of the State."

*Minnesota:* Freeman v. Minneapolis, etc. R. Co., 28 Minn. 443 (1881), (10 N. W. Rep. 594).

*New Jersey:* A corporation created by statute possesses no rights, and can exercise no powers, which are not expressly given or necessarily implied. Such a corporation cannot lease or dispose of any franchise needful in the performance of its obligations to the State, without legislative consent. Stockton v. Central R. Co., 50 N. J. Eq. 52 (1892), (24 Atl. Rep. 964). Also Mills v.

In *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*<sup>1</sup> Mr. Justice Miller thus applied the principle of *ultra vires* to railroad leases: "We think it may be stated, as the just result of these cases and on sound principle, that, unless specially authorized by its charter or aided by some other legislative action, a railroad company cannot, by lease or any other contract, turn over to another company, for a long period of time, its road and all its appurtenances, the use of its franchises, and the exercise of its powers; nor can any other railroad company, without similar authority, make a contract to receive and operate such road, franchises, and property of the first corporation, and that such a contract is not among the ordinary powers of a railroad company, and is not to be presumed from the usual grant of powers in a railroad charter."

And in the earlier case of *Thomas v. Railroad Co.*<sup>2</sup> the same Justice, after discussing the doctrine of *ultra vires*, said: "There is another principle of equal importance and equally conclu-

Central R. Co., 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453); *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 130 (1871); s. c. 24 N. J. Eq. 454 (1873).

*Pennsylvania*: *Van Steuben v. Central R. Co.*, 178 Pa. St. 367 (1896), (35 Atl. Rep. 992).

*South Carolina*: *Harmon v. Columbia, etc. R. Co.*, 28 S. C. 401 (1887), (5 S. E. Rep. 835, 13 Am. St. Rep. 686).

*Texas*: *International, etc. R. Co. v. Moody*, 71 Tex. 614 (1888), (9 S. W. Rep. 465); *Gulf etc. R. Co. v. Morris*, 67 Tex. 692 (1887), (4 S. W. Rep. 156); *Central, etc. R. Co. v. Morris*, 68 Tex. 49 (1887), (3 S. W. Rep. 457).

*Vermont*: *Nelson v. Vermont, etc. R. Co.*, 26 Vt. 717 (1854), (62 Am. Dec. 614).

*Virginia*: *Roper v. McWhorter*, 77 Va. 214 (1883).

*West Virginia*: *Ricketts v. Chesapeake, etc. R. Co.*, 33 W. Va. 433 (1890), (10 S. E. Rep. 801, 25 Am. St. Rep. 901, 7 L. R. A. 354): "We think it may be stated, as the just result of the decided cases, and on

sound principle, that a railroad corporation cannot, without distinct legislative authority, by lease, or any other contract, turn over to another company its road and the use of its franchises, and thereby exempt itself from responsibility for the conduct and management of the road." Also *Fischer v. West Virginia R. Co.*, 39 W. Va. 366 (1894), (9 S. E. Rep. 578).

*England*: An agreement between two railway companies, made without the authority of the legislature, whereby one company delegates to another all the powers which have been conferred upon it by parliament, is an unlawful attempt to effect that which parliament alone can authorize, and is against public policy. *Great Northern R. Co. v. Eastern Counties R. Co.*, 12 Eng. L. & Eq. 224 (1851), 9 Hare, 306.

<sup>1</sup> *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*, 118 U. S. 309 (1886), (6 Sup. Ct. Rep. 1094).

<sup>2</sup> *Thomas v. Railroad Co.*, 101 U. S. 83 (1879).

sive against the validity of this contract, which, if not coming exactly within the doctrine of *ultra vires* as we have just discussed it, shows very clearly that the railroad company was without the power to make such a contract. That principle is that where a corporation, like a railroad company, has granted to it by charter a franchise intended, in large measure, to be exercised for the public good, the due performance of those functions being the consideration of the public grant, any contract which disables the corporation from performing those functions, which undertakes, without the consent of the State, to transfer to others the rights and powers conferred by the charter, and to relieve the grantees of the burden which it imposes, is a violation of the contract with the State, and is void as against public policy."

§ 178. **Necessity for Legislative Authority to take a Lease.** — Legislative authority is as necessary to take as to make a lease. A railroad company, unless expressly authorized, has no power to accept a lease of the railroad and franchises of another corporation. Such an act, unauthorized, is both *ultra vires* and opposed to public policy. One corporation cannot assume the performance of the public duties of another unless the State approve.

If either party to a lease of a railroad is acting without authority it is void. A contract beyond the powers of either is as invalid as if beyond the powers of both.<sup>1</sup>

§ 179. **Legislative Ratification of Unauthorized Lease.** — While legislative authority is essential to the validity of a lease of a railroad it is not necessary that it should be granted *before* the execution of the lease. The legislature may cure invalidity

<sup>1</sup> St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co., 145 U. S. 404 (1892), (12 Sup. Ct. Rep. 953); Central Transp. Co. v. Pullman Car Co., 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); Pittsburgh, etc. R. Co. v. Keokuk, etc. Bridge Co., 131 U. S. 371 (1889), (9 Sup. Ct. Rep. 770); Oregon R., etc. Co. v. Oregonian R. Co., 130 U. S. 36 (1889); Pennsylvania Co. v. St. Louis, etc. R. Co., 118 U. S. 310 (1886), (6 Sup. Ct.

Rep. 1094); Thomas v. Railroad Co., 101 U. S. 82 (1879); Rogers v. Nashville, etc. R. Co., 91 Fed. 316 (1898). Also Louisville, etc. R. Co. v. Kentucky, 161 U. S. 691 (1896), (16 Sup. Ct. Rep. 714); Winch v. Birkenhead, etc. R. Co., 16 Jur. 1035 (1835). And see *ante*, § 139: "*Legislative Authority essential to Purchase of Franchises*"; *ante*, § 144: "*Seller must have Authority to sell and Buyer to buy.*"

by subsequent ratification, and, when ratified, a contract stands as if authorized in the first instance.<sup>1</sup> Thus, a lease of a railroad and franchises, unauthorized when made either by the corporation's articles of incorporation or by statute, was held to be validated by an act of the legislature subsequently passed conferring such authority.<sup>2</sup>

Legislative ratification must be clearly expressed. A reference to "lessees," in an act regulating rates of fare upon a railroad operated under an unauthorized lease, does not validate it. "It is not by such an incidental use of the word

<sup>1</sup> *Terre Haute, etc. R. Co. v. Cox*, 102 Fed. 825 (1900). See also the following cases of mortgages and consolidations without authority made binding by subsequent legislative ratification which involve principles applicable to cases of leases.

*United States*: *Graham v. Boston, etc. R. Co.*, 118 U. S. 161 (1886), (6 Sup. Ct. Rep. 1009); *Gross v. U. S. Mortgage Co.*, 108 U. S. 447 (1883), (2 Sup. Ct. Rep. 940); *Galveston R. Co. v. Cowdrey*, 11 Wall. (U. S.) 459 (1870); *Whitewater, etc. Canal Co. v. Valette*, 21 How. (U. S.) 414 (1858); *Hall v. Sullivan R. Co.* 11 Fed. Cas. 257 (1857), (2 Redfield Am. Ry. Cas. 621, 21 Law Rep. 138).

*Illinois*: *U. S. Mortgage Co. v. Gross*, 93 Ill. 483 (1879), (s. c. 108 U. S. *supra*); *Mitchell v. Deeds*, 49 Ill. 416 (1867), (95 Am. Dec. 621); *Racine, etc. R. Co. v. Farmers Loan, etc. R. Co.*, 49 Ill. 331 (1868), (95 Am. Dec. 595); *Hatcher v. Toledo, etc. R. Co.*, 62 Ill. 477 (1872), (6 Am. R. Rep. 405).

*Maine*: *Kennebec, etc. R. Co. v. Portland, etc. R. Co.*, 59 Me. 1 (1871); *Shepley v. Atlantic, etc. R. Co.*, 55 Me. 395 (1868).

*Massachusetts*: *Shaw v. Norfolk County R. Co.*, 5 Gray 162 (1855).

*New Hampshire*: *Richards v. Merimack, etc. R. Co.*, 44 N. H. 127 (1862).

See *ante*, § 20: "Legislative Sanction — how expressed."

<sup>2</sup> *Terre Haute, etc. R. Co. v. Cox*, 102 Fed. 825 (1900). In this case Judge Grosscup said: "From the moment the act was passed the two railway companies had the power to enter into a lease containing provisions such as are here sought to be enforced. Thenceforth such power existed under the laws of Indiana. Had the two companies, at any time thereafter, formally adopted the lease, under the act giving authority, no one would insist that the lease was *ultra vires*. An adoption of the lease, otherwise unauthorized, under an act conferring authority, must be distinguished from an attempted ratification without any new statutory authority. In the one case the law is changed so that the contemplated agreement is no longer unlawful; in the other the contemplated ratification, if held valid, would, in effect, substitute, on the question of power, the will of the corporation for the will of the legislature. But an adoption of the agreement embodied in the lease, in the light of the new power conferred, may be implied from conduct, as well as from a formal act of readoption.

. . . It is not an attempted overreaching of the law, by the ratification of an unauthorized act; but is, in effect, a readjustment of the companies' relations to the powers conferred by the new legislative authority."



'lessees' . . . that a contract, unauthorized by the charter and forbidden by public policy, is to be made valid and ratified by the State."<sup>1</sup>

Ratification by the legislature must be distinguished from ratification by stockholders. The stockholders of a corporation may ratify an irregularity in the exercise of granted powers; the State alone can make good an act beyond the scope of those powers.<sup>2</sup>

§ 180. **What Railroads may be leased. Statutory Provisions.** — The power to lease railroads is, in many cases, granted in conjunction with a grant of power to sell them. Divers statutes of this character are included in the summary printed in connection with the subject of sales of railroads. Other statutes relating only to railroad leases are collected in the footnote.<sup>3</sup>

<sup>1</sup> *Thomas v. Railroad Co.*, 101 U. S. 85 (1879). See also *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409).

<sup>2</sup> *Louisville, etc. R. Co. v. Louisville Trust Co.*, 174 U. S. 552 (1899), (19 Sup. Ct. Rep. 817), and cases cited.

<sup>3</sup> *Alabama*. See *ante*, § 145 ("Sales").

*Arizona*. Code 1896, § 1171: "Any railroad company incorporated by the laws of any other State and now owning or which is authorized to own or operate, by lease or otherwise, any railroad in this State," may "aid any railroad company incorporated under any . . . law of this State . . . by leasing . . . any such railroad, on such terms as may be agreed upon by the respective boards of directors." See also *ante*, § 145 ("Sales").

*Arkansas*. See *ante*, § 145 ("Sales").

*California*. Pomeroy's Code 1901, § 473 (a): "Railroad corporations doing business in this State, and organized under the law of this State, or of the United States, or any other State or Territory thereof, have power to enter into contracts with one

another whereby the one may lease of the other the whole or any part of its railroad."

*Colorado*. See *ante*, § 145 ("Sales").

*Connecticut*. G. S. 1902, § 3702: "Any company may make lawful contracts with any other company with whose railroad its tracks may connect or intersect . . . and may take a lease of the property or franchises of, or lease its property or franchises to, any such company."

*Florida*. See *ante*, § 145 ("Sales").

*Georgia*. See *ante*, § 145 ("Sales").

*Idaho*. See *ante*, § 145 ("Sales").

*Iowa*. See *ante*, § 145 ("Sales").

*Kansas*. G. S. 1897, ch. 70, § 94: "Any railroad company shall have power to lease its road and appurtenances to any railroad corporation organized under the laws of this State, or any adjoining State, when the road so leased shall thereby become on the operation thereof a continuation and extension of the road of the company accepting such lease." For additional statutes see *ante*, § 145 ("Sales").

*Maine*. See *ante*, § 145 ("Sales").

*Maryland*. See *ante*, § 145 ("Sales").

*Massachusetts*. Supp. to Rev.

These statutes, as a general rule, limit the right to make and take leases to railroad companies owning or operating connecting lines.

Laws, 1906, ch. 112, § 209: "Two railroad corporations created by this Commonwealth, whose roads enter upon or connect with each other . . . ; and any such corporation may lease its road to any other such corporation." [This section, however, does not authorize a lease between two corporations, each of which has a terminus in Boston.] "The roads of two railway companies shall be deemed to enter upon or connect with each other . . . if one of such roads enters upon, connects with, or intersects a road leased to the other, or operated by it under a contract."

*Ib.* § 210: "No railroad shall lease . . . its road for a period of more than ninety-nine years."

*Michigan.* See *ante*, § 145 ("Sales").

*Minnesota.* See *ante*, § 145 ("Sales").

*Mississippi.* Code 1906, § 4079: "Every railroad corporation organized under the provisions of this chapter shall have and exercise the following powers, rights, and privileges, viz:—" —

(*Ib.* § 4090). "To lease its railroad and all its property and franchises, rights, powers, privileges, and immunities then owned or thereafter to be acquired, or to lease other railroads, in or out of this State, not in either case parallel or competing lines, for a term of years."

*Missouri.* See *ante*, § 145 ("Sales").

*Montana.* See *ante*, § 145 ("Sales").

*Nebraska.* See *ante*, § 145 ("Sales").

*New Hampshire.* Pub. Stat. & Sess. Laws 1901, ch. 156, § 21, p. 503: "Any railroad corporation may lease

its railroad . . . to any other railroad corporations for such a length of time and upon such terms as may be agreed to by the lessor and lessee corporations at meetings of their respective stockholders . . . by a two-thirds vote of all the stock represented and voting at such meetings."

*Ib.* § 44, p. 506: Foreign corporations operating roads within this State shall have the same rights for the purpose of leasing other roads as if created by the laws of this State.

*New Jersey.* See *ante*, § 22, note ("Consolidation").

*New Mexico.* Comp. Laws 1897, § 3847: Every corporation formed under this act shall have the following powers: (15) "To lease the whole or any portion of its railroad . . . to any other corporation formed under this act or . . . under the laws of any other State or Territory, with the road of which its road may connect and form a continuous line of travel and transportation." (16) "To take leases of such other railroads . . . as are mentioned in the last preceding subdivision of this section."

For additional statutes, see *ante*, § 145 ("Sales").

*New York.* R. S. 1901 (Birds-eye's) Railroad Law, § 78: "Any railroad corporation or any corporation owning or operating a railroad route within this State may contract with any other such corporation for the use of their respective roads or routes in such manner . . . as prescribed . . . in such contract . . . and if such contract shall be a lease of any such road, and for a longer period than one year," it shall not be binding "unless approved by the

Power to take a lease of a railroad within the State is, as a general rule, conferred indiscriminately upon domestic and foreign corporations.

votes of stockholders owning at least two-thirds of the stock of each corporation which is represented and voted upon in person or by proxy at a meeting called separately for that purpose."

*North Carolina.* Laws 1885, ch. 108, p. 159, § 2: "Any railroad . . . may lease any railroad or branch railroad . . . in this or any adjoining State connecting with it, directly or indirectly."

*North Dakota.* See *ante*, § 145 ("Sales").

*Ohio.* Bates' Anno. Stat. (1787-1906), § 3384 (a): "Any consolidated company . . . of this State or any other State, may . . . lease . . . any railroad . . . of this State or of any other State, if the line of road covered by such lease . . . is connected with the line of road of such consolidated railroad company, upon such terms as may be agreed upon between the companies."

For additional statute, see *ante*, § 145 ("Sales").

*Oklahoma.* See *ante*, § 145 ("Sales").

*Oregon.* See *ante*, § 145 ("Sales").

*Pennsylvania.* Bright Purd. Dig. 1894, § 153, p. 1810: (Act of March 13, 1847), relates to the running of cars on connecting railways.

*Ib.* § 154, p. 1810: The act of March 13, 1847, "shall be so construed as to authorize companies owning any connecting railroads in the State of Pennsylvania to enter into any lease . . . with each other."

*Ib.* § 156, p. 1810: "It shall be lawful for any railroad companies to enter into contracts for the use or lease of any other railroads upon such terms as may be agreed upon. . . . Provided, that the roads of the com-

panies so contracting or leasing shall be directly, or by means of intervening railroads, connected with each other."

*Ib.* § 169, p. 1812: "Any railroad company or companies . . . of this Commonwealth" may "lease or become the lessees, by assignment or otherwise, of any railroad or railroads . . . whether the road or roads embraced in such lease . . . may be within the limits of this State, or created by or existing under the laws of any other State or States . . . . Provided, however, that the road or roads, so embraced in any such lease . . . shall be connected, either directly, or by means of an intervening line, with the railroad or railroads of said company or companies of this Commonwealth so entering into such lease . . . and thus forming a continuous route or routes for the transportation of persons and property."

*South Carolina.* See *ante*, § 145 ("Sales").

*South Dakota.* See *ante*, § 145 ("Sales").

*Tennessee.* Code 1896, § 1538: "Any railroad company owning any main line may contract with any company owning a railroad connecting with such main line for the lease thereof."

For additional statutes, see *ante*, § 145 ("Sales").

*Texas.* Sayles' Civ. Stat. 1897 (Supp. to 1900), vol. 2, ch. 15a (Acts 1899, p. 73): "Any railroad now or hereafter constructed, not exceeding thirty miles in length, connected at or near the State line with any other railroad, may be leased by the company owning such other railroad" for not exceeding ten years.

*Utah.* Laws 1901, ch. 26, p. 23, § 7: "Any railroad . . . of this State may lease and operate . . . a rail-

The term for which leases of railroads may be taken is generally unlimited. In Massachusetts, however, it cannot exceed ninety-nine years.

The English "Railway Leasing Act," which forbids the lease of any railway "unless under a distinct provision of an Act specifying the parties" seems to be a "leasing act" in the negative.

§ 181. **Rule of Construction of Statutes.** — A statute granting powers to a corporation is construed strictly, against the grantee and in favor of the public. In grants by the public everything must be expressed; nothing passes by implication.<sup>1</sup>

road owned by any other company within or without this State; and any railroad . . . of the United States, or of any State or Territory, may lease and operate . . . the railroad owned by a company of this State."

This act does not permit leasing of competing lines.

For additional statute, see *ante*, § 145 ("Sales").

*Vermont.* Stat. 1894, § 3747: "Railroad companies in this State may make contracts and arrangements with each other, and with railroad corporations . . . of other of the United States, or . . . of the Dominion of Canada, for leasing and running the roads of the respective corporations, or a part thereof."

*Washington.* See *ante*, § 145 ("Sales").

*West Virginia.* Code 1906, § 2346. See *ante*, § 22, note, where this statute is shown with reference to consolidations.

*Wisconsin.* See *ante*, § 145 ("Sales").

*Wyoming.* See *ante*, § 145 ("Sales").

*England.* "The Railway Leasing Act," 8 & 9 Vict. c. 96 (1845), provides that no railway company shall grant or accept a lease or transfer of any railway unless under a distinct

provision of an Act specifying the parties.

<sup>1</sup> *Charles River Bridge v. Warren Bridge*, 11 Pet. (U. S.) 420 (1837); *Dubuque, etc. R. Co. v. Litchfield Co.* 23 How. (U. S.) 66 (1859); *Turnpike Co. v. Illinois*, 96 U. S. 63 (1877); *Slidell v. Grandjean*, 111 U. S. 412 (1884), (4 Sup. Ct. Rep. 475); *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409).

In *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478), the Supreme Court of the United States said: "By a familiar rule, every public grant of property, or of privileges or franchises, if ambiguous, is to be construed against the grantee and in favor of the public; because an intention, on the part of the government, to grant to private persons, or to a particular corporation, property or rights in which the whole public is interested, cannot be presumed, unless unequivocally expressed or necessarily to be implied in the terms of the grant, and because the grant is supposed to be made at the solicitation of the grantee, and to be drawn up by him or by his agents, and therefore the words used are to be treated as those of the grantee; and this rule of construction is a wholesome safeguard of the interests of the public against any attempt of the grantee, by the insertion of am-

The intention of the legislature to authorize a railroad company to lease its railroad and franchises must clearly appear or the power will not exist.<sup>1</sup> In case of doubt, a construction will not be given which will authorize a *quasi*-public corporation to disable itself from performing the duties for which it was created. In fact, it has been said that to justify a railroad company in claiming authority to lease its railroad to another corporation "it must be able to point to the exact statute granting such authority."<sup>2</sup>

The correct rule is, undoubtedly, that grants are to be strictly construed, but that the intention of the legislature is not to be defeated by an unreasonably strict construction.<sup>3</sup>

§ 182. **Construction of Statutes — (A) Provisions authorizing Leases.** — Power to purchase outright is said to include power to lease and operate for a definite term. Upon similar principles, it is held that where a railroad company, under its charter, has power both to construct a railroad for another corporation to operate, and to operate a railroad in its own behalf, it has power to lease a railroad for its own operation.<sup>4</sup>

"Power to receive a lease from a connecting railroad corporation implies power in favor of the latter to give it."<sup>5</sup>

biguous language, to take what could not be obtained in clear and express terms."

<sup>1</sup> *United States: Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409); *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094).

*Nebraska: State v. Atchison, etc. R. Co.*, 24 Neb. 143 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164).

*New Jersey: In Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 130 (1871), the Chancellor distinguished between a primary grant of franchises and an act authorizing the transfer of existing franchises, holding that the latter did not require the same strict rule of construction applicable in the case of the former. This distinction, however,

was not approved by the appellate court, and cannot be justified in principle. 24 N. J. Eq. 455 (1873).

*Texas: East Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690).

<sup>2</sup> *State v. Atchison, etc. R. Co.*, 24 Neb. 161 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164).

<sup>3</sup> See *ante*, § 27: "*General Rule of Construction*" ("*Consolidation*"); *ante*, § 146: "*Construction of Statutes*" ("*Sales*").

<sup>4</sup> *Kaufman v. Pittsburg, etc. R. Co.*, 217 Pa. 599 (1907), (66 Atl. Rep. 1108).

<sup>5</sup> *Hunting v. Hartford St. R. Co.*, 73 Conn. 179 (1900), (46 Atl. Rep. 824). In this case the Court also said: "It was among the franchises granted to the defendant to purchase or take leases of the property and franchises of any other street railway

An Illinois statute<sup>1</sup> authorizing domestic railroad companies to make "contracts and arrangements with each other, and with railroad corporations of other States, for leasing and running their roads, or any part thereof," has been held by the Supreme Court of the United States to include, by the use of the words "their roads," not only roads of other domestic, but foreign, corporations and to confer power to make, as well as to take, leases.<sup>2</sup> Power to construct a branch railroad will carry with it by implication power to lease a branch already constructed, but such power cannot be exercised after the right to construct has expired. The loss of the right involves the deprivation of all powers flowing from it.<sup>3</sup>

companies, with which its tracks might connect. The Railroad Company, being one of these connecting companies, and authorized by its charter to lay tracks on Burnside Avenue at the place in question, leased all its property and franchises to the defendant, for the term of thirty years, shortly before the latter constructed its tracks there. It was authorized to make such a lease by the charter of the defendant."

Where the charter of a railroad company empowers it to take a lease of the property of another company the latter has implied power to make the lease — there being nothing in its charter to prevent.

*Kaufman v. Pittsburg, etc. R. Co.*, 217 Pa. St. 599 (1907), (66 Atl. Rep. 1108).

<sup>1</sup> *Illinois*: Statute of February 12, 1855; Priv. Laws 1885, p. 304; Rev. Stat. 1874, ch. 114, § 34.

<sup>2</sup> *St. Louis, etc. R. Co. v. Terre Haute R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953). Compare *Black v. Delaware, etc. Canal Co.*, 22 N. J. Eq. 130 (1871), reversed in 24 N. J. Eq. 455 (1873).

Authority granted to a railroad corporation to lease a railroad connected with its own does not permit it to lease its own road to another company. *Mills v. Central R. Co.*,

41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453).

A statute conferring authority upon a railroad company to lease its property is confined, in its operation, to property within the State. *Briscoe v. Southern Kansas R. Co.*, 40 Fed. 273 (1889).

A Massachusetts statute authorizing "any railroad corporation created by this State" to lease its road to another corporation "so created" authorizes the making of a lease by a corporation formed by a consolidation of a domestic corporation with a corporation of another State; the consolidated company being in Massachusetts a corporation of that State. *Peters v. Boston, etc. R. Co.*, 114 Mass. 127 (1873).

A statute authorizing a railroad company to acquire and use certain ferry franchises does not authorize it to lease such franchises to a foreign railroad company and thereby relieve itself from the attendant liabilities.

*Brooker v. Maysville, etc. R. Co.*, 119 Ky. 137 (1904), (83 S. W. Rep. 117).

<sup>3</sup> *Camden, etc. R. Co. v. May's Landing, etc. R. Co.*, 48 N. J. L. 530 (1886), (7 Atl. Rep. 523).

A provision in the charter of a railroad company authorizing it to "make contracts with individuals,

Under a statute authorizing railroad corporations to lease their properties and franchises without limiting the term, a lease for nine hundred and ninety-nine years, although amounting practically to a conveyance of the fee, is valid. Such leases have frequently been made and the legislature in enacting the statute without qualification will not be presumed to have intended to exclude them.<sup>1</sup>

Power to "farm out" the right of transportation has been held by the Supreme Court of North Carolina to be equivalent to power to lease.<sup>2</sup> The phrase "to farm out," however, is an English one and, as applied to railroads, usually means the grant of running privileges.

When a corporation is authorized to take a lease of a railroad and franchises it may acquire the same through an assignment of the lease from an existing lessee.<sup>3</sup>

corporations and other railroad companies for the building, completion and operating of said road or any part thereof," gave it power to lease the road.

*McCabe's Admx. v. Maysville, etc. R. Co.*, 112 Ky. 861 (1902), (66 S. W. Rep. 1054).

<sup>1</sup> *Dickinson v. Consolidated Traction Co.*, 119 Fed. 872 (1903): "The suggestion that, 'for all substantial and practical purposes, a lease for 999 years is a conveyance in fee,' is without force. The question is not as to what may be the practical effect of the particular instrument, but as to its authorization; and, as corporation leases for 999 years were well known when, by the statutory provisions to which we have referred, the power to lease was broadly and unqualifiedly given, we are not at liberty to assume that the exercise of that power was intended to be restricted to leases for a term not to exceed some limited, but wholly undefined and indeterminate, period."

See also *Wormser v. Metropolitan St. R. Co.*, 98 App. Div. (N. Y.) 29 (1904), (90 N. Y. Supp. 714).

<sup>2</sup> *State v. Richmond, etc. R. Co.*, 72 N. C. 634 (1875).

In *Hill v. Atlantic, etc. R. Co.*, 143 N. C. 541 (1906), (55 S. E. Rep. 854) the Court said: "The charter of the defendant company conferring the right to transport passengers and freight, and giving the power to 'farm out' the right of transportation, authorizes the company, by the former decisions of this Court, to execute a valid lease of its property and franchises to another railroad company."

The same phrase is used in a Georgia statute, and has been held to confer power upon a railroad company to lease its property and franchises including the right to use and maintain terminal yards.

*Georgia R. Co. v. Maddox*, 116 Ga. 63 (1902), (42 S. E. Rep. 315).

<sup>3</sup> *Stewart v. Long Island R. Co.*, 102 N. Y. 601 (1886), (8 N. E. Rep. 200, 55 Am. Rep. 844).

An ordinance authorizing street railway companies, their successors and assigns to sell or lease their properties and franchises to other corporations, their successors and assigns

The New York statute of 1839<sup>1</sup> providing that "it shall be lawful for any railroad corporation to contract with any other railroad corporation for the use of their respective roads and thereafter to use the same in the manner prescribed in said contract" has been repeatedly held by the courts of that State to authorize a lease. As said by Judge Gray in *Beveridge v. New York Elevated R. Co.*:<sup>2</sup> "The act of 1839 has more than once been construed to authorize such a lease. The power therein conferred upon a railroad corporation to contract with another for the use of their respective roads, in such manner as the contract may prescribe, involves the power to make a lease for a term of years."<sup>3</sup>

§ 183. **Construction of Statutes — (B) Provisions not authorizing Leases.** — In contrast to the construction of the New York statute referred to in the last section, an Indiana statute<sup>4</sup> authorizing a domestic railroad company "to make such con-

empowers a purchasing corporation to itself exercise the power to lease without obtaining the further consent of the municipality, notwithstanding a constitutional provision forbidding the transfer of street railway franchises without such consent.

*Moorshead v. United Rys. Co.*, 119 Mo. App. 541 (1906), (96 S. W. Rep. 261); *affirmed*, 203 Mo. 121 (1907), (100 S. W. Rep. 611).

<sup>1</sup> Laws of 1839, ch. 218.

<sup>2</sup> *Beveridge v. New York Elevated R. Co.*, 112 N. Y. 21 (1889), (19 N. E. Rep. 489).

<sup>3</sup> See also *Day v. Ogdensburg, etc. R. Co.*, 107 N. Y. 129 (1887), (13 N. E. Rep. 765); *Woodruff v. Erie R. Co.*, 93 N. Y. 609 (1883); *People v. Albany, etc. R. Co.*, 77 N. Y. 232 (1879); *Fisher v. New York Central, etc. R. Co.*, 46 N. Y. 644 (1871); *Gere v. New York Central, etc. R. Co.*, 19 Abb. N. C. 193 (1885). Compare *Troy, etc. R. Co. v. Boston, etc. R. Co.*, 86 N. Y. 107 (1881), where Judge Danforth said concerning the act of 1839: "Assuming that the statute permits a grant of the exclusive right

to use a road, and does not contemplate a mere traffic arrangement, by which each of two companies may use the other's road, is the instrument called a lease, a contract for 'use,' within its meaning?"

In *Wormser v. Metropolitan St. R. Co.*, 98 App. Div. (N. Y.) 37 (1904), (90 N. Y. Supp. 714), the Court said: "It is well known that under the act of 1839 it was strongly contended that no larger or greater interpretation could be given to the permission thereby conferred than that running arrangements might be made by one railroad corporation with another. But it was held, as the proper interpretation of that statute, that it permitted the leasing of one railroad to another which contemplated the virtual abandonment of everything connected with the lessor road and the vesting of it in the lessee." See also *Metropolitan El. R. Co. v. Manhattan R. Co.*, 14 Abb. N. C. 201 (1884).

<sup>4</sup> *Indiana*: Rev. Stat. (1881), § 3973.



tracts and agreements" with a connecting railroad in an adjoining State "for the transportation of freight and passengers, or for the use of its said road, as to the board of directors may seem proper," was held by the Supreme Court of the United States not to confer authority to make contracts beyond those relating to forwarding passengers and freight, and, possibly, to the use of the road of the one company by the other in running its cars to their destination.<sup>1</sup> The title to this act included the clause, "to connect their roads with the roads of other companies," and the Supreme Court of Indiana, in construing the act, said: "To connect one road with another does not fairly mean to lease or sell it to another."<sup>2</sup>

A provision in the charter of a railroad corporation authorizing it "to make contracts and engagements with any other corporation, or with individuals, for transporting or conveying any kinds of goods, produce, merchandise, freight or passengers," merely authorizes contracts relating to the carriage of goods or passengers and cannot be construed as authorizing a lease.<sup>3</sup> A statute authorizing a corporation to contract

<sup>1</sup> *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 311 (1886), (6 Sup. Ct. Rep. 1094); *St. Louis, etc. R. Co. v. Terre Haute R. Co.*, 145 U. S. 405 (1892), (12 Sup. Ct. Rep. 593); *Commissioners of Tippecanoe County v. Lafayette, etc. R. Co.*, 50 Ind. 85 (1875).

<sup>2</sup> *Commissioners of Tippecanoe County v. Lafayette, etc. R. Co.*, 50 Ind. 110 (1875), (*per Biddle, J.*).

<sup>3</sup> *Thomas v. Railroad Co.*, 101 U. S. 80 (1879): "The authority to make this lease is placed by counsel primarily in the following language of the thirteenth section of the company's charter: 'That it shall be lawful for the said company, at any time during the continuance of its charter, to make contracts and engagements with any other corporation, or with individuals, for the transporting or conveying of any kinds of goods, produce, merchandise, freight, or passengers, and to enforce the fulfilment of such contracts.' This is no more

than saying, 'you may do the business of carrying goods and passengers, and may make contracts for doing that business. Such contracts you may make with any other corporation or with individuals.' No doubt a contract by which the goods received from railroad or other carrying companies should be carried over the road of this company, or by which goods or passengers from this road should be carried by other railroads, whether connecting immediately with them or not, are within this power, and are, probably, the main object of the clause. But it is impossible, under any sound rule of construction, to find in the language used a permission to sell, lease, or transfer to others the entire road and the rights and franchises of the corporation. To do so is to deprive the company of the power of making those contracts which this clause confers and of performing the duties which it implies."

with other corporations "for the leasing or hiring and transfer to them" of its "railway cars and other personal property" authorizes the lease of such cars in the regular course of business, but does not warrant the corporation in making a long lease to a single corporation of its entire personal property.<sup>1</sup>

The use of the words "assigns" and "successors," in connection with the powers granted to railroad companies in their charters, or in general laws, does not necessarily imply that they may transfer all their property by lease. The use of such words recognizes the possibility of a transfer under statutory authority but does not itself grant the authority.<sup>2</sup> The phrase "passing over," as used in the English Railway Clauses Act,<sup>3</sup> does not refer to a lease but means "passing, with the incidents which ordinarily attach to passing over, that is to say, the incidents of stopping and of taking up, at the points at which they do stop, both passengers and goods."<sup>4</sup>

A general incorporation act authorizing the formation of corporations for "any lawful purpose" does not authorize a corporation created thereunder to assume to itself the power of leasing railroads, because of the mere declaration in its articles of association that it possesses such power.<sup>5</sup> A con-

<sup>1</sup> *Central Transp. Co. v. Pullman Palace Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478).

<sup>2</sup> *Thomas v. Railroad Co.*, 101 U. S. 71 (1879); *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 311 (1886), (6 Sup. Ct. Rep. 1094); *Briscoe v. Southern Kan. R. Co.*, 40 Fed. 278 (1889). In *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 30 (1889), (9 Sup. Ct. Rep. 409), Mr. Justice Miller said: "One of the most important powers with which a corporation can be invested is the right to sell out its whole property together with the franchises under which it is operated, or the authority to lease its property for a long term of years. In the case of a railroad company, these privileges, next to the right to build and operate its railroad, would be the most important which could be given it, and this idea would impress itself upon the

legislature. Naturally, we would look for the authority to do these things in some express provision of law. We would suppose that if the legislature saw fit to confer such rights it would do so in terms which could not be misunderstood. To infer, on the contrary, that it either intended to confer them or to recognize that they already existed, by the simple use of the word 'assigns,' a very loose and indefinite term, is a stretch of the power of the court in making implications which we do not feel to be justified."

<sup>3</sup> 8 Vict. ch. 20.

<sup>4</sup> *Simpson v. Denison*, 10 Hare, 57 (1852), (16 Jur. 828).

<sup>5</sup> *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409).

The New York statute of 1839 which for a long time furnished the sole authority for railroad leases, pro-

stitutional provision<sup>1</sup> prohibiting parallel or competing roads from being consolidated is a restriction upon the powers of the corporations owning such roads, and is not to be construed as a grant of authority to non-competing corporations to lease.<sup>2</sup>

§ 184. **Construction of Statutes — (C) Power to lease Unfinished Road.** — Power to construct does not give power to take a lease and, conversely, power to take a lease does not give power to construct.<sup>3</sup> Where, therefore, the statute authorizing railroad leases is inapplicable to roads not yet constructed, a lease by a railroad company of its road and franchises before its road is completed is invalid, and the lessee acquires no right to finish the work.<sup>4</sup> Thus it was held that a statute authorizing the leasing of a railroad and conferring upon the lessee power "to run, use and operate" the road implied a finished road, as did a condition that the leased roads should be connected; and that, under such authority, the franchise for building a road could not be transferred.<sup>5</sup>

While power to construct will not be implied from a grant of power to take a lease, power to enter into an executory contract for leasing, when completed, a railroad in process of construction, may fairly be implied from such a grant of power.<sup>6</sup>

vided that nothing therein should authorize the railroad of any corporation to be used in a manner inconsistent with its charter. The charter of a railroad company authorized it to construct and operate its road between certain termini. It sought to lease a portion of its road to another corporation which would have rendered it impossible for the lessor to have constructed and operated the road between the termini prescribed in the charter. It was held that the statute did not authorize such a lease.

Brooklyn, etc. R. Co. v. Long Island R. Co., 72 App. Div. (N. Y.) 496 (1902), (76 N. Y. Supp. 777).

<sup>1</sup> Texas, Const. Art. X. § 5.

<sup>2</sup> Central, etc. R. Co. v. Morris, 68 Tex. 49 (1887), (3 S. W. Rep. 457).

<sup>3</sup> Oregon R., etc. Co. v. Oregonian

Co., 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409).

<sup>4</sup> Wood v. Bedford, etc. R. Co., 8 Phila. 94 (1871); Clarke v. Omaha, etc. R. Co., 4 Neb. 458 (1876), (sale).

<sup>5</sup> Wood v. Bedford, etc. R. Co., 8 Phila. 94 (1871).

<sup>6</sup> Jones v. Concord R. Co., 67 N. H. 234 (1892), (30 Atl. Rep. 614, 68 Am. St. Rep. 650); March v. Eastern R. Co., 40 N. H. 548 (1860), (77 Am. Dec. 732); Hazard v. Vermont, etc. R. Co., 17 Fed. 753 (1883). In Day v. Ogdensburg, etc. R. Co., 107 N. Y. 129 (1887), (13 N. E. Rep. 765), the road was finished in performance of an agreement entered into at the same time the lease was agreed upon, and it was held that the lease was valid — that the parties intended a completed road and before the lease was executed the road was completed.

The construction of a railroad requires the exercise of powers dissimilar to those required in the operation of a leased road. An agreement for a lease — or a lease to commence *in futuro* — involves merely the exercise in an uncommon form of the power conferred. As somewhat broadly stated by the Supreme Court of New Hampshire in *Jones v. Concord R. Co.*:<sup>1</sup> “Whatever may be the practical effect of a conveyance or lease of a building or road that does not exist, the corporate power of hiring a road, like the power of hiring a passenger or freight station, includes the power of making an executory contract for a lease of a road or building to be constructed within a time or in a place or manner or form, prescribed by the contract.”

§ 185. **Construction of Statutes — (D) Leases of Connecting Lines.** — As already shown, statutes authorizing railroad leases generally provide that railroad companies may lease their roads to corporations owning roads which form continuous or connecting lines with their own.<sup>2</sup> The construction of statutes of this character has been the subject of extended consideration in connection with similar limitations attached to the right to consolidate, and the principles there shown to be established apply with equal force to statutes authorizing leases.<sup>3</sup>

<sup>1</sup> *Jones v. Concord R. Co.*, 67 N. H. 243 (1892), (30 Atl. Rep. 614, 68 Am. St. Rep. 650).

<sup>2</sup> See *ante*, § 180: “*What Railroads may be leased. Statutory Provisions.*”

<sup>3</sup> See *ante*, § 29: “*Construction of Statutes authorizing Consolidation of Railroads — Connecting or Continuous Lines.*”

Power to take a lease from a connecting railroad company implies power in the latter to make a lease.

*Hunting v. Hartford St. Ry. Co.*, 73 Conn. 179 (1900), (46 Atl. Rep. 824).

An inclined-plane railway company organized under the laws of Pennsylvania, has authority, under statutes of that State, to lease its entire property to another railway company, where one of the lessor's lines forms a continuous route with the lessee's road, notwithstanding the break

caused by the inclined plane, in the line of the former. An absolute passage for a car from one road to another without interruption is not necessary to constitute a “connected or continuous” line within the meaning of the statutes in question.

*Hampe v. Traction Co.*, 165 Pa. St. 468 (1895), (30 Atl. Rep. 931).

The general statutes of *Pennsylvania* referred to in the preceding case requiring the railroads of lessor and lessee to be connected, do not apply to corporations chartered by the legislature upon which express power to merge, consolidate or unite, without such condition, is conferred by another statute.

*Kaufman v. Pittsburgh, etc. R. Co.*, 217 Pa. 599 (1907), (66 Atl. Rep. 1108).

Under a *Georgia* statute a belt line company may lease its road to another

§ 186. **Constitutional and Statutory Prohibitions of Leases of Competing or Parallel Lines.** — The leasing by railroad companies of competing or parallel lines of road is prohibited by constitutional and statutory provisions in many States.

The same and similar prohibitions, the considerations of public policy which induced their adoption, and their construction and application, have already been examined at length in the consideration of the subject of consolidation.<sup>1</sup>

§ 187. **Long-term Leases not prohibited by Statutes against Perpetuities.** — The question has been judicially raised whether a lease in perpetuity or for nine hundred and ninety-nine years comes within the prohibition of statutes against perpetuities as suspending the disposition of the leased property longer than the periods prescribed in such statutes. A slight examination of the question, however, will show clearly that a lease does not create a perpetuity. A perpetuity was defined, in the early case of *Scattergood v. Edge*,<sup>2</sup> to be an estate "inalienable though all mankind joined in the conveyance." But the interests of lessor and lessee may generally be separately conveyed; and they can always, by uniting, freely and without restraint convey the entire estate — the fee and the leasehold interest.<sup>3</sup>

company with whose road it connects or forms a continuous line.

*Georgia R. etc. Co. v. Maddox*, 116 Ga. 64 (1902), (42 S. E. Rep. 315).

<sup>1</sup> See *ante*, ch. III. . "*Constitutional and Statutory Restraints upon Consolidation.*"

The constitutional provisions against leases of competing lines — as well as consolidation and sales — are collected, and many statutes referred to, in note to § 32, *ante*: "*Constitutional and Statutory Provisions*

*against Consolidation of Competing Railroads.*"

<sup>2</sup> *Scattergood v. Edge*, 1 Salk. 229 (1795). In *Washburn v. Donnes*, 1 Ch. Cas. 23 (1671), it is said: "A perpetuity is where if all that have interest join and yet cannot bar or pass the estate."

<sup>3</sup> *Todhunter v. Des Moines, etc. R. Co.*, 58 Iowa, 205 (1882), (12 N. W. Rep. 267, 7 Am. & Eng. R. Cas. 67), where the question stated in the text is considered.

## CHAPTER XVII

## APPROVAL AND EXECUTION OF CONTRACT OF LEASE

*I. Assent of Stockholders to Railroad Lease*

- § 188. Necessity for Consent of Stockholders to Lease of Railroad. Power of Directors.
- § 189. Whether Unanimous Consent is necessary unless otherwise provided.
- § 190. Requisite Majority prescribe Terms of Lease.
- § 191. Remedies of Dissenting Stockholders.
- § 192. Acquiescence and Laches of Stockholders.

*II. Method of approving and executing Railroad Leases*

- § 193. Statutory Requirements.
- § 194. Construction of Statutes prescribing Mode of approving and executing Leases.
- § 195. Formalities attending Execution of Lease of Railroad.
- § 196. Corporation may be estopped from alleging Irregular Execution of Lease.

*I. Assent of Stockholders to Railroad Lease*

§ 188. **Necessity for Consent of Stockholders to Lease of Railroad. Power of Directors.** — The New York Court of Appeals has held that a lease by one railroad corporation to another of its road, property and franchises for a term of years, under a statute conferring the power but not prescribing its mode of exercise, may be made by the directors of the corporation, and that the concurrence of the stockholders is not essential to its validity.<sup>1</sup> The ground upon which this decision was placed was that all powers conferred upon a corporation, unless otherwise expressly prescribed, must be exercised by its directors, — that the consent of stockholders is not necessary to the validity of a corporate act, unless expressly required by statute or the by-laws of the corporation. This conclusion is, however, opposed by other authorities and cannot be justified upon principle.

<sup>1</sup> *Beveridge v. New York Elevated R. Co.*, 112 N. Y. 1 (1889), (19 N. E. Rep. 489, 2 L. R. A. 648). See also

*Conro v. Port Henry Iron Co.*, 12 Barb. (N. Y.) 27 (1851).

The directors of a corporation are its executive agents — the corporation acts through them — but their *duties are to administer its affairs in furtherance of the objects of its creation.*<sup>1</sup> They may exercise all ordinary and incidental corporate powers without the approval of the stockholders, but the extraordinary power of leasing the corporate property and franchises for a long term of years — of completely changing the control of the property and the administration of the affairs of the corporation — must be exercised by the stockholders themselves, unless expressly conferred upon the directors.<sup>2</sup> When

<sup>1</sup> The directors of a railroad company are its agents with limited powers and their duties are to so conduct its affairs as to further the ends of its creation; they have no power to destroy it or give away its funds or deprive it of any of the means for accomplishing the purposes for which it was chartered. *Bedford R. Co. v. Bowser*, 48 Pa. St. 29 (1864).

Where an increase of the capital stock of a corporation was authorized "at the pleasure of the said corporation" and its charter provided that "all the corporate powers of the said corporation shall be vested in and exercised by a board of directors" it was held that the directors had no authority to increase the stock, upon the ground that "the general power to perform all corporate acts refers to the ordinary business transactions of the corporation." *Railway Co. v. Allerton*, 18 Wall. (U. S.) 234 (1873).

<sup>2</sup> *United States*: In *Cass v. Manchester*, etc. R. Co., 9 Fed. 642 (1881), Judge McKennan, in considering the necessity for the stockholders' consent to a lease, said: "The change proposed here is not organic, it is true, but it is thorough and fundamental, as it affects the administration of the company's affairs. It involves a withdrawal from the control and management of the stockholders of the entire property of the corporation for a period of at least five years; it will

preclude for a like period the exercise annually by the stockholders of their judgment as to the particular character and method of conducting the business affairs of the corporation; and it denies to the stockholders any right of suggestion or disapproval of the conditions upon which a relinquishment of important corporate faculties may be conceded. Surely a power which will be attended with such consequence does not relate 'to the ordinary business transactions,' nor 'to the orderly and proper administration of the affairs,' of the company, and hence cannot be exercised by the directors without express authority to them."

*Rogers v. Nashville*, etc. R. Co., 91 Fed. 322 (1898): "The power of leasing out a railroad, or acquiring another by lease, is one which very vitally affects the contract between shareholders. That every such contract should be referred to the shareholders is, therefore, most reasonable; and it should not be lightly presumed that the law-making power would, when dealing with the general subject, intend to provide that some contracts of this character should be submitted to the shareholders for their approval, while others just as vital might be made without their consent." Also *Farmers Loan*, etc. Co. v. *St. Joseph*, etc. R. Co., 1 McCrary 247 (1880).

*Indiana*: Commissioners of Tippi-

the statute conferring power to lease is silent as to the mode of its exercise a lease of a railroad must be authorized, or, what is equivalent, ratified by the stockholders.

The right of the stockholders to authorize a lease and the necessity for their approval are in no way affected by the fact that the directors have agreed upon the terms of the lease.<sup>1</sup>

§ 189. **Whether Unanimous Consent is necessary unless otherwise provided.** — As shown in another section, statutes authorizing leases of railroads nearly always prescribe the proportion of the stockholders whose consent is necessary. Where, however, the statute contains no such provision, a question arises whether the unanimous consent of the stockholders is required or whether the consent of a majority is sufficient. Thus, on the one hand, it has been held that a lease for a long term of

canoe County v. Lafayette, etc. R. Co., 50 Ind. 85 (1875).

*New York:* Metropolitan El. R. Co. v. Manhattan El. R. Co., 11 Daly 373 (1884), (15 Am. & Eng. R. Cas. 55, 14 Abb. N. C. 103). In this case (decided before the *Beveridge* case *supra*) the Court said: "If the board of directors have the power, without the assent of the shareholders, to lease the properties of the corporation for all time, then the shareholders may be deprived of, not only the administration of their property through its agents, the directors, but its very possession, without a moment's warning. A board of directors are elected for one year, to manage the business and affairs of the corporation, such business being the operating and maintaining of a railroad. At the time of their election, the shareholders have no intimation that anything else is to be done by the directors, and the expectation is that such directors, at the end of their year in office, will turn over the property committed to them to their successors in office, with an account of their stewardship. Can it be possible that this board, elected for only one year, without any notice or warning has the power

to terminate the business of the corporation, and transfer all the properties to another corporation? It seems to me clearly not. This is not the management of the business of the corporation. It is terminating the business to carry on which it was incorporated."

*Pennsylvania:* Kersey Oil Co. v. Oil Creek, etc. R. Co., 12 Phila. 374 (1877). Also Martin v. Continental Pass. R. Co., 14 Phila. 10 (1880).

*Virginia:* Stevens v. Davison, 18 Gratt. 819 (1868), (98 Am. Dec. 692).

See also *ante*, § 112: "*Sale of Entire Corporate Property by Directors.*"

It has been held that the consent of stockholders, necessary for the authorization of a lease, is required for its cancellation. Henry v. Pittsburgh, etc. R. Co., 2 Ohio N. P. 118 (1895).

A modification of a lease must be approved by the same stockholders' vote as is required by the statute in the case of the original lease. Continental Ins. Co. v. New York, etc. R. Co. 187 N. Y. 225 (1907), (79 N. E. Rep. 1026).

<sup>1</sup> Jones v. Concord, etc. R. Co., 67 N. H. 234 (1892), (30 Atl. Rep. 614, 68 Am. St. Rep. 650).



years works such a complete change in the conduct of the affairs of a corporation and the custody of its property that it can be brought about only by the unanimous consent of the stockholders.<sup>1</sup> On the other hand, it has been held that every stockholder in joining a corporation impliedly agrees to be bound by the will of the majority, and that it is the right of the majority to determine whether or not a lease — which makes no organic change — shall be made.<sup>2</sup> “It is true this doctrine,” says

<sup>1</sup> *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453). See also *Zabriskie v. Hackensack*, etc. R. Co., 18 N. J. Eq. 178 (1867).

In *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881), the Court said: “Such an arbitrary deprivation of property it cannot be within the power of a majority in a corporation to direct or of a legislature to ratify. If this could be upheld no investment in a corporation would be secure, for any minority could be deprived of their property by a vote of a majority confirmed by legislative act, without the requirement of public necessity and without provision for ‘just compensation.’”

<sup>2</sup> *Dady v. Georgia*, etc. R. Co., 112 Fed. 842 (1901), (consolidation); *Inhabitants of Waldoborough v. Knox*, etc. R. Co., 84 Me. 469 (1892), (24 Atl. Rep. 942) (sale). See also *Durfee v. Old Colony R. Co.*, 5 Allen (Mass.) 230 (1862).

In *Dickinson v. Consolidated Traction Co.*, 114 Fed. 933 (1902), *affirmed*, 119 Fed. 871 (1903), — a New Jersey case, — the Court followed the principle of the New Jersey decisions cited in the preceding note in holding that where authority to lease is not conferred until *after* the organization of the corporation unanimous consent is necessary to authorize a lease; but that when such power existed at the time the corporation was organized, a majority vote is sufficient. Judge Gray said (p. 253): “The objection most strenuously and seriously urged,

is that although express power may be given to a corporation to lease, that power cannot, in the absence of express legislative authority to the contrary, be exercised without the consent of all the stockholders. It is urged with some plausibility, that without express legislative authority, a corporation could not make a lease of its property and franchises, even with the assent of all its stockholders, and that express legislative authority to make a lease is only a conferring of a power not existent without such legislative grant, upon the whole body of stockholders. Many cases have been cited in the brief and in the argument, to support these propositions. The distinction, however, between these cases and the one at bar, is, that the former concern grants of legislative power to lease, to corporations already in existence, and whose stockholders have subscribed under the conditions of the original charter, by which no such power was given. The implied contract between the stockholders, *inter sese*, in such cases, is, as already stated, that no such additional power, so radical in its nature, though conferred by legislative authority, shall be capable of being exercised without the assent of all the stockholders. In the case before us, however, the power to lease was conferred by the act under which both corporations were formed. It was inherent in their organization and corporate existence, and was a condition upon which every stock-

the Supreme Court of Maine,<sup>1</sup> "subjects minorities to the will of majorities; but it is equally true that the contrary doctrine subjects majorities to the will of minorities; and since one side or the other must yield, it seems to us more in harmony with the principles of natural justice that it should be the minority."

Upon principle, it seems the better view that where authority to make or take a lease is expressly granted to an existing railroad company and, *a fortiori*, where it appears in the laws under which the corporation is organized, the authority becomes a power of the corporation which, in the absence of a controlling statutory provision, may be exercised in the same manner as other powers requiring action by the stockholders — by a majority vote.

§ 190. **Requisite Majority prescribe Terms of Lease.** — Where the charter of a corporation or a general law authorizes it, by a vote of a prescribed majority of its stockholders, to lease its property and franchises, and contains no restrictions as to the terms of the lease or the rent to be reserved, the majority may agree upon such provisions and rental as they see fit, and the minority stockholders have no remedy, except in case of fraud.<sup>2</sup>

Thus, where the charter of a railroad corporation authorized it, without restriction, by a vote of three-fourths of its stockholders to lease its railroad, it was held that a lease so entered into for ninety-nine years, at a rent not exceeding the amount needed to pay fixed charges and dividends on the preferred stock was, in the absence of fraud, valid, although the possi-

holder received his stock. It was competent for the legislature to have imposed in its creative act any conditions it pleased upon the stockholders of the corporation which it had called into existence. The power to lease having been so given, without prescribing any mode in which it was to be exercised, it must be classed with the general powers conferred by a charter, which are to be exercised by the majority of the corporators or stockholders."

See also *ante*, § 149: "Assent of

*Stockholders.* — *Whether Approval of Majority is sufficient.*"

<sup>1</sup> *Inhabitants of Waldoborough v. Knox, etc. R. Co.*, 84 Me. 469 (1892), (24 Atl. Rep. 942).

<sup>2</sup> Where the majority are authorized to lease the property and franchises of a corporation and no limitation is placed upon the term of the lease, a lease for so long a term as to amount practically to a conveyance of the fee may be executed.

*Dickinson v. Consolidated Traction Co.*, 119 Fed. 871 (1903).

bility of any dividend being paid on the common stock was thereby excluded for the entire term.<sup>1</sup>

The conclusion reached in the case referred to, while the logical outcome of the application of fixed principles to the provisions of the charter, was most inequitable. The rule that the majority may prescribe the terms and conditions of a lease is founded upon an elementary principle in corporation law, and where there is only one class of stockholders works fairly. But that preferred stockholders, interested in securing a certain payment of their limited dividends, may with the aid of a minority of the holders of the common stock obtain a perpetual guaranty of their dividends and deprive the common stockholders of any chance of return from the enhanced value of their property, is opposed to principles of natural justice. A rule producing such result, under forms of law, should be the subject of legislative enactment. Selfishness may work as grievous wrongs as fraud.

§ 191. **Remedies of Dissenting Stockholders.** — The protection of the interests of minority stockholders from the un-

<sup>1</sup> *Town of Middletown v. Boston, etc. R. Co.*, 53 Conn. 358 (1885), (5 Atl. Rep. 706), where Judge Beardsley said: "But it is claimed that although there is no restriction in the language of the charter as to the term for which the company may lease its road, or as to the rent to be received, yet it is unreasonable so to construe it as to enable three-fourths of the stockholders to make a lease which deprives the other fourth of any chance for dividends for so long a period, and hence that the lease in question is not a rightful and lawful exercise of the power given by the charter. We see no ground for this claim, especially in view of the fact that leases of railroads are, and from the nature of the case must generally be, made for long terms. Railroads are leased, as they are built, with a view to the advantages to arise in the distant future from the development of population and business in the neighborhood by the facilities for

transportation which they afford. The complaint also charges that, by the provision of the lease, the entire resources of the defendant company from which income can be derived are fraudulently appropriated for the benefit of the holders of the preferred stock. This is not a charge of fraudulent conduct or intent in the making of the lease, but only that, by its operation, the income will be fraudulently appropriated for the benefit of the preferred stockholders. This is simply an allegation that this appropriation of the income will be disastrous to the common stockholders and wrongful; not that the preferred stockholders have acted fraudulently. If the company had the right, as it clearly had by its charter, to make the lease upon a three-fourths vote, the Court cannot regard the effect of the lease as wrongful, or in any proper sense fraudulent."

authorized acts of the majority, and of the interests of every stockholder from the unlawful acts of those intrusted with the management of the affairs of a corporation, is peculiarly within the province of equity.<sup>1</sup> Upon this principle a court of equity at the instance of a stockholder in a corporation which has, without authority, agreed to lease its property and franchises, or which has agreed to accept an unauthorized lease from another corporation, will grant an injunction against both corporations, parties to the agreement, restraining the execution of the lease.<sup>2</sup> Thus, where the directors of a railroad company, without the approval of its stockholders and without sanction of law, made a lease of its railroad for ninety-nine years, it was held that such lease was *ultra vires* and void, and that an action would lie in behalf of any stockholder against both corporations for an injunction and for the cancellation of the lease.<sup>3</sup>

### § 192. Acquiescence and Laches of Stockholders. — Upon

<sup>1</sup> In *Pond v. Vermont Valley R. Co.*, 12 Blatch. (U. S.) 287 (1874), upon a stockholder's bill to restrain an unauthorized lease of a railroad, about to be consummated by directors, Judge Woodruff said: "It is not insisted, and cannot be successfully claimed, that the matters complained of are not of equity cognizance; or that a court, having general jurisdiction in equity, has no jurisdiction, at the instance of stockholders, to restrain a corporation, or those engaged in the control and management of its affairs, from acts tending to the destruction of its franchises, or violations of the charter or from misuse or misappropriation of the corporate powers or property, or other acts prejudicial to the stockholders, amounting to a breach of trust on the part of the managers."

<sup>2</sup> *Winch v. Birkenhead, etc. R. Co.*, 5 De Gex & Sm. 562 (1852), (16 Jur. 1035, 13 Eng. L. & Eq. 506); *Commissioners of Tippecanoe County v. Lafayette, etc. R. Co.*, 50 Ind. 85 (1875); *Mills v. Central R. Co.*, 41

N. J. Eq. 1 (1886), (2 Atl. Rep. 453); *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 33 Fed. 447 (1888), s. c. on appeal, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953). See also *post*, § 248: "*Voidable Railroad Leases*" and cases cited, for consideration of remedies of minority stockholders in case of unfair leases.

<sup>3</sup> *Commissioners of Tippecanoe County v. Lafayette, etc. R. Co.*, 50 Ind. 85 (1875).

Where, however, the directors of a corporation with the approval of the majority of the stockholders leased its property for a long term of years to another corporation in which they became interested, it was held that a court of equity would not, at the suit of a minority stockholder, annul the lease, in the absence of proof of fraud or that the lease was detrimental to the interests of the lessor corporation.

*Dickinson v. Consolidated Traction Co.*, 114 Fed. 232 (1902); *affirmed* 119 Fed. 871 (1903).

principles similar to those already considered in connection with the subjects of consolidation and sale, a stockholder by his acquiescence may waive irregularities in the execution of a lease of a railroad and may be estopped by his laches from taking steps to have it set aside.<sup>1</sup> Statutes providing that a prescribed majority of stockholders must assent to a lease in a particular manner, and other provisions of a similar character, are enacted in the interest of the stockholders. The compliance with these regulations may be a condition precedent to the validity of the lease as against a stockholder, but he may be estopped by acquiescence and delay from setting up the invalidity.<sup>2</sup> Thus an Illinois statute requiring the

<sup>1</sup> See *ante*, § 49: "*Laches of Stockholders*"; *ante*, § 116: "*Defences to Stockholders' Actions. Estoppel*"; *ante*, § 150: "*Acquiescence of Stockholders*."

Although a stockholder in a railroad company, by voting for the lease of its road to another company, is estopped — as between himself and his corporation — from attacking its validity, the corporation is not estopped to proceed against the lessee for the avoidance of the lease; and the estoppel against the stockholder does not prevent him from instituting proceedings for such purpose *in the name of the corporation* when such procedure is otherwise permissible. *Memphis, etc. R. Co. v. Grayson*, 88 Ala. 572 (1889), (7 So. Rep. 122, 16 Am. St. Rep. 69).

<sup>2</sup> *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953), (s. c. 33 Fed. 447 (1888)). Citing *Zabriskie v. Cleveland, etc. R. Co.*, 23 How. (U. S.) 381 (1859); *Central Transportation Co. v. Pullman Car Co.*, 139 U. S. 60 (1891), (11 Sup. Ct. Rep. 478); *Davis v. Old Colony R. Co.*, 131 Mass. 258 (1881), (41 Am. Rep. 221); *Beecher v. Marquette, etc. R. Co.* 45 Mich. 103 (1881), (7 N. W. Rep. 695); *Thomas v. Citizens R. Co.*, 104 Ill. 462 (1882). See also *Taylor v. Railroad Co.*, 4 Woods (U. S.), 575

(1882). In the *Terre Haute* case *supra* Mr. Justice Gray said (p. 403): "Although this statute, in terms, declares that any such lease, made without the written consent of the Illinois stockholders, 'shall be null and void,' it would seem to have been enacted for the protection of such stockholders alone, and intended to be availed of by them only. It did not limit the scope of the powers conferred upon the corporation by law, an excess of which could not be ratified or be made good by estoppel; but only prescribed regulations as to the manner of exercising corporate powers, compliance with which the stockholders might waive, or the corporation might be estopped, by lapse of time, or otherwise, to deny."

*Hill v. Atlantic, etc. R. Co.*, 143 N. C. 539, 558 (1906), (55 S. E. Rep. 854): "While a court of equity will interpose at the suit of a single stockholder to enjoin acts done by the officers of a corporation irregularly or in excess of their powers, which are injurious to his rights, or acts *ultra vires*, yet if he has stood by until the transaction to which he objects has become executed, he will not afterwards be heard to complain; and this is so although the party who may have dealt with the corporation in the particular case knew of

written consent of all the Illinois stockholders to a lease of a railroad in that State to a foreign corporation, was held to be for the personal benefit of the stockholders which they could waive by acquiescence. Judge Gresham said:<sup>1</sup> "The silence of the stockholders for almost twenty years was equivalent to their written consent. Any resident stockholder might have enjoined the execution and performance of the contract by a suit brought in due time, but no such suits could be maintained after an acquiescence for the period stated, and no one but a stockholder could object to the contract on that ground."

the irregularity of the proceedings or the invalidity of the transaction."

In this case (*Hill v. Atlantic, etc. R. Co., supra*) a stockholder with knowledge of the execution of a lease maintained silence for more than a year, during which time the lessee expended large sums of money in carrying out its part of the agreement, and it was held that by such delay he had lost the right to object to the lease.

A stockholder's action to set aside an alleged illegal lease will not be sustained where there is no charge that the directors or stockholders had been requested to take action to have it declared void, and it has been acquiesced in for five years.

*Latimer v. Richmond, etc. R. Co.*, 39 S. C. 44 (1892), (17 S. E. Rep. 258).

A delay of three months, however, is not laches. *Mills v. Central R. Co.*, 41 N. J. Eq. 1 (1886), (2 Atl. Rep. 453).

As to what constitutes acquiescence, see *Kersey Oil Co. v. Oil Creek, etc. R. Co.*, 12 Phila. 374 (1877), where the Court said (p. 376): "It is further contended that the contract and lease cannot be rescinded because the plaintiff company is estopped by its acquiescence and silence. What is

acquiescence? It is something more than non-resistance. It is more than mere passiveness, unless the passiveness induces belief in error, and then it becomes an act."

See also *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881).

A statute ratifying an important railroad lease provided that: "Every stockholder of either the lessor or the lessee shall be deemed to consent to the contract of lease authorized by this act, unless he shall file with the clerk of the lessee a writing declaring his dissent therefrom. . . The shares of any stockholder dissenting as above specified shall be acquired by the lessee and shall be valued and the value thereof be paid or tendered or deposited to or for the account of such stockholder." It was held that this provision did not require the lessee to buy the shares of stockholders who had voted for the lease and then, after the enactment of the ratification statute, had filed declarations of dissent.

*Boston, etc. R. Co. v. Graham*, 179 Mass. 62 (1901), (60 N. E. Rep. 405).

<sup>1</sup>*St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 33 Fed. 447 (1888), *affirmed* 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953).

## II. Method of approving and executing Railroad Leases

§ 193. **Statutory Requirements.** — The uniform policy indicated in statutes authorizing leases of railroads is to place restrictions upon the exercise of the power granted, to require the formal approval of a prescribed majority of the stockholders of the contracting corporations, and to prescribe the method to be followed in the adoption of the lease.<sup>1</sup> Thus it

*Alabama.* Code 1896, § 1170: Approval of proposed lease by holders of majority in value of stock of both corporations at meetings called for the purpose required.

*Arizona.* R. S. 1901, par. 864: Assent of holders of two-thirds of entire capital stock of each corporation — by vote or in writing — necessary to contract of lease.

*Arkansas.* Kirby's Dig. 1904, §§ 6742, 6752, 6762: Proposed lease must be assented to by holders of two-thirds of capital stock of each corporation after conditions and terms are agreed to by directors.

*Colorado.* Mills' Anno. Stat. 1891, § 612 (as amended by Sess. Laws 1899, p. 163): Assent of holders of two-thirds of capital stock of each company required to proposed lease.

*Connecticut.* G. S. 1902, § 3703: "No lease of any railroad shall be binding on either of the contracting parties for a period of more than twelve months, unless approved of by the stockholders of the companies that are parties to the lease, by a vote of two-thirds of the stock represented at a meeting of the stockholders called for that purpose."

*Georgia.* Code 1895, § 2179, p. 128: Terms of lease are such as may be agreed upon. No particular method provided.

*Kansas.* G. S. 1897, § 95: Terms and conditions of lease must be agreed to by directors and must be ratified by vote of the holders of two-thirds of capital stock of each company or

approved by such holders in writing. See also *ib.* ch. 70, § 94.

*Massachusetts.* Supp. to Rev. Laws 1906, ch. 112, § 209: Directors agree upon the terms which must be "approved by a majority in interest of the stockholders of both corporations at meetings called for that purpose."

*Michigan.* P. A. 1901, Act No. 30, p. 50: "Stockholders owning a majority of stock of said companies shall consent thereto."

*Minnesota.* G. S. 1894, §§ 721, 2736: Lease must be assented to by holders of two-thirds of capital stock of each company at meetings called for the purpose.

*Missouri.* R. S. 1899, § 1060: Holders of a majority of stock of each company must assent in writing to lease proposed by directors before it can be perfected.

*Montana.* Code 1895, § 912 requires approval of three-fifths of stockholders. *Ib.* § 923 requires approval by majority vote or by majority in writing. These provisions apply to leases authorized by different statutes.

*Nebraska.* Comp. Stat. 1901, § 1769: No lease shall be perfected until assented to by vote of holders of two-thirds of capital stock; (*ib.* § 4026), by vote or written approval of like number. *Ib.* §§ 4018, 4019, authorize approval of certain leases by majority vote.

*New Hampshire.* See statute in note to § 180, *ante*: "What Rail-

is generally provided that the proposed lease shall not become effective until it shall have been approved by a vote of the holders of a designated majority of the capital stock of each corporation. In several States, however, formal action by the stockholders may be dispensed with if the specified number give their assent in writing and certificates showing the approval of the lease are filed in the office of the Secretary of State.

Some of these statutory requirements constitute conditions precedent to the validity of the lease. Others are directory only.

§ 194. **Construction of Statutes prescribing Mode of approving and executing Leases. Ratification.** — Statutes prescribing the method of approving and executing leases of railroads are, in the essential elements, mandatory and must be strictly complied with.

A provision that no lease of a railroad shall be perfected until the stockholders of the contracting corporations shall have approved it by their votes at stockholders' meetings requires their approval in that form. Their consent obtained individually, outside of the meetings, is not sufficient. Deliberate action as stockholders is necessary.<sup>1</sup> Conversely, a pro-

*roads may be leased. Statutory Provisions."*

*New Jersey.* See statute in note to § 22, *ante*.

*New Mexico.* Comp. Laws 1897, § 3891: Holders of at least two-thirds of capital stock must assent to proposed lease.

*New York.* See statute in note to § 180, *ante*: "*What Railroads may be leased. Statutory Provisions.*"

*North Dakota.* Rev. Codes 1899, § 2954: Lease must be approved in same manner as consolidation. See *ante*, § 52: "*Formal Statutory Requisites*" ("*Consolidation*").

*Ohio.* Bates' Anno. Stat., 1878-1906, § 3301: Two-thirds of stockholders must approve proposed lease at meeting called by each corporation.

*South Dakota.* Anno. Stat. 1901, § 3906: Lease must be approved in

same manner as consolidation. See *ante*, § 52: "*Formal Statutory Requisites*" ("*Consolidation*").

*Tennessee.* Code 1896, § 1540: Lease must be approved by votes of holders of three-fourths of capital stock.

*West Virginia.* Code 1899, ch. 54, § 82a: Lease requires approval of holders of two-thirds of capital stock at meeting called for the purpose.

*Wyoming.* R. S. 1899, § 3206: Lease must be approved by vote of holders of a majority of stock, or their written approval may be given.

<sup>1</sup> In *Peters v. Lincoln, etc. R. Co.*, 2 McCrary 275 (12 Fed. 514) (1881), Judge McCrary said: "The legislature has seen fit to provide that no lease of a railroad in this State, executed by one railroad company to another,



vision that a proposed lease may be executed if a majority of the stockholders have assented in writing is not complied with by the casting of ballots in its favor by a majority of stockholders at a meeting where it has been the subject of consideration. Ballots do not contain the signatures of stockholders. They are cast to accomplish corporate, and not individual, action.<sup>1</sup>

Where an act of Parliament authorized one railroad company to grant, and another railroad company to accept, a lease of a railroad upon such terms as should be agreed upon, but

shall be completed until a meeting of the stockholders of both companies shall have been called by the directors thereof or until such lease has been assented to by the votes of at least two-thirds of the stock represented. In our judgment the stockholders' meeting and the vote in such meeting upon the question of assenting to the proposed lease are matters of essence, of substance and not of mere form. . . . The action of stockholders outside of such meeting is individual action only. It is not such action as the law requires. It does not bind the corporation." See also same case upon amended bill, 14 Fed. 319 (1882).

In *Smith v. Hurd*, 12 Met. (Mass.) 385 (1847), (46 Am. Dec. 690), Chief Justice Shaw thus stated the relation of a stockholder, in his individual capacity, to his corporation: "Should all the stockholders join in a power of attorney to any one, he could not take possession of any real or personal estate, any security or chose in action; could not collect a debt, or discharge a claim or release damage arising from any default; simply because they are not the legal owners of the property, and damage done to such property is not an injury to them. Their rights and their powers are limited and well defined."

See also *Humphreys v. McKissock*, 140 U. S. 304 (1891), (11 Sup. Ct. Rep. 779).

<sup>1</sup> *Humphreys v. St. Louis, etc. R. Co.*, 37 Fed. 313 (1889): "No vote at any meeting was required by the laws of Missouri, if the holders of a majority of the stock assented to the lease in writing, and the proper certificates were filed in the office of the Secretary of State. The propositions voted upon were in writing, and the voting was by written ballots. This is argued to have been an assent in writing to the lease; but the ballots were not signatures, and were cast to accomplish corporate, and not individual, action. This does not seem to amount to the assent in writing contemplated by the statute."

Under a New York statute, however, requiring the written consent of two-thirds of the stockholders to a mortgage, it was held that a resolution passed at a stockholders' meeting by the vote of stockholders holding two-thirds of the stock amounted to the written assent required. *Beebe v. Richmond Light, etc. Co.*, 13 Misc. Rep. 737 (1895), (35 N. Y. Supp. 1).

A statute authorized a railroad company to enter into an agreement for a lease with the assent of two-thirds of its shareholders. *Held*, that holders of registered bonds, having voting powers, might vote upon the question. *Hendrie v. Grand Trunk R. Co. (Ont.)*, 13 Am. & Eng. R. Cas. 62 (1883).

provided that the power should not be exercised until the Board of Trade had certified that it had been proved to its satisfaction that half the capital of the leasing company had been raised and applied for the purposes of the act, it was held that no lease or binding agreement for a lease could be made before the certificate had been obtained.<sup>1</sup>

Where power to make a lease is vested in the stockholders and they have agreed upon its terms and conditions, the directors have no power, without the consent of the stockholders, to make any material change in the terms agreed upon.<sup>2</sup>

Irregularities in a stockholders' meeting at which a lease is authorized may be cured by appropriate action at a subsequent meeting. Thus where a railroad company voted to lease its road at a special stockholders' meeting of which one stockholder had no notice, but at the annual meeting held subsequently, of which he had due notice, a resolution to set aside the lease, introduced at his instance, was defeated, it was held that this action constituted a ratification of the lease and relieved it of any irregularity by reason of the want of notice of the first meeting.<sup>3</sup>

#### § 195. Formalities attending Execution of Lease of Railroad.

— When the statutory requirements essential to the authorization of a railroad lease have been complied with, the matter of its formal execution is governed by principles applicable to corporations generally in the execution of conveyances.<sup>4</sup>

<sup>1</sup> Kent Coast, etc. R. Co. v. London, etc. R. Co., L. R. 3 Ch. App. 656 (1868).

<sup>2</sup> Met. El. R. Co. v. Man. El. R. Co., 11 Daly, 373 (1884), (14 Abb. N. Cas. 103, 15 Am. & Eng. R. Cas. 51). Compare, however, People v. Met. El. R. Co., 26 Hun, 82 (1881).

<sup>3</sup> Hill v. Atlantic, etc. R. Co., 143 N. C. 539 (1906), (55 S. E. Rep. 854).

<sup>4</sup> That an agreement to give a lease does not require, in its execution, the formalities necessary in the execution of the lease itself, and that a decree of specific performance may be entered against a corporation, see Conant v. Bellows Falls Canal Co., 29 Vt. 263 (1857).

Regarding the formalities required in *modifying* the provisions of a duly executed lease, the New York Court of Appeals in the recent case of Continental Ins. Co. v. New York, etc. R. Co., 187 N. Y. 225, 242 (1907), (79 N. E. Rep. 1026) said: "It is urged that the compromise agreement was in effect a new lease modifying the provision for rent reserved in the old lease, and that not sufficient in amount of the Central stockholders voted for its adoption to render the agreement valid in law as a lease. We concede that a modification of a lease must be executed with the same formalities and with the same vote as required by stat-

1. *Place of Execution.* The meeting of the stockholders for the authorization of a proposed lease must be held within the State where the corporation is chartered. When the lease is authorized, it may be executed by the proper officers within or without the State.<sup>1</sup>

2. *Authority of Officers or Agents.* While the authority of the officers or agents of a corporation to execute a lease must be shown, written evidence of a formal vote is not necessary, and it may be implied from facts and circumstances. In the absence of proof to the contrary, the law presumes that the acting officers of a corporation are rightfully in office, and it is not necessary to prove their election to establish the validity of their acts.<sup>2</sup>

ute in the case of an original lease."

<sup>1</sup> *Pittsburgh, etc. R. Co. v. Columbus, etc. R. Co.*, 8 Biss. (U. S.) 456 (1879).

In *Wright v. Bundy*, 11 Ind. 404 (1858), the Court said: "The mere place where the active agents of a corporation enter into a contract must, in general, be immaterial. The important question arising must be one of power, not of place. The exercise of the power has relation to the place of their legal establishment, where the contract may be subsequently acted under. The meetings of the directors of a business corporation are not analogous to the sessions of a judicial tribunal. The corporation is organized by the election of directors; but the mere organization of the directors into a corporation for business afterwards, is quite a different thing."

Where the president of a railroad company operating a railroad in Kentucky acknowledged the execution of a mortgage thereof in Ohio it was held that the mortgage was properly executed. *Hodder v. Kentucky, etc. R. Co.*, 7 Fed. 793 (1881), affirmed *sub nom.* *Wright v. Kentucky, etc. R. Co.*, 117 U. S. 72 (1886), (6 Sup. Ct. Rep. 697).

For principle applicable to interstate consolidated corporation, see *Graham v. Boston, etc. R. Co.*, 14 Fed. 753 (1883), affirmed 118 U. S. 161 (1886), (6 Sup. Ct. Rep. 1009).

<sup>2</sup> In *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 51 Fed. 327 (1892), affirmed 163 U. S. 564 (1896), (16 Sup. Ct. Rep. 1173), Judge Sanborn said: "The Pacific Company delivered this contract, signed by its president and secretary, to the Rock Island Company. This was *prima facie* evidence that it was executed in behalf of the corporation by lawful authority." See also *Susquehanna Bridge, etc. Co. v. General Ins. Co.*, 3 Md. 305 (1852), (56 Am. Dec. 740); *Jacksonville, etc. R. Co. v. Hooper*, 160 U. S. 519 (1895), (16 Sup. Ct. Rep. 379).

Where a committee of three directors were given discretionary power to execute a lease of corporate property, it was held that two of the members had power to affix the corporate seal, the third member being absent but having approved the execution of the lease. *Union Bridge Co. v. Troy, etc. R. Co.*, 7 Lans. (N. Y. 240 (1872)).

Where, however, a resolution provided "that the president and treasurer of this association be, and they are hereby authorized to exe-

3. *Seals.* A seal is necessary upon a written lease made by a corporation only when it is required upon a similar lease made by a natural person.<sup>1</sup> When a seal is necessary, and a contract purporting to be sealed is shown to have been duly signed and executed by the proper officers, the law will presume that the seal was affixed by proper authority.<sup>2</sup>

4. *Acknowledgment, Witnesses, etc.* Statutory provisions concerning the execution of a lease of real estate adopted in the State where the railroad is situated, prescribing the number of witnesses, form of acknowledgment, etc., are, undoubtedly, applicable to railroad companies in the execution of leases of their roads. Failure to comply with such provisions, however, does not, as a general rule, affect the validity of the lease between the parties.

5. *Record.* A failure to record the lease of a railroad in the office of the Secretary of State or otherwise as the statute may prescribe will not, unless expressly so provided, affect its validity as between the parties.<sup>3</sup>

cute and deliver . . . a lease," it was held that the authority of the two officers was joint, and that a lease executed by one of them alone was invalid. *Pond v. Vermont Valley R. Co.*, Fed. Cas. No. 11, 263 (1876).

<sup>1</sup> *United States Bank v. Dandridge*, 12 Wheat. (U. S.), 64 (1828).

<sup>2</sup> *Fidelity Insurance, etc. Co. v. Shenandoah Valley R. Co.*, 32 W. Va. 224 (1889), (9 S. E. Rep. 180, 38 Am. & Eng. R. Cas. 577). Also *Jacksonville, etc. R. Co. v. Hooper*, 160 U. S. 519 (1895), (16 Sup. Ct. Rep. 379).

<sup>3</sup> The general principle that the recording of a deed or lease is only necessary for the purpose of giving notice, and that an unrecorded lease is as valid between the lessor and lessee as if recorded, is undoubtedly as applicable to leases of railroad and other corporations as to those of natural persons. The following cases illustrate this general principle: *Coleson v. Blunton*, 3 Haywood (Tenn.), 152 (1816); *Galpin v. Abbot*, 6

Mich. 17 (1858); *Lawry v. Williams*, 13 Me. 281 (1836); *Stearns v. Morse*, 47 N. H. 532 (1867); *Turner v. Stip*, 1 Wash. (Va.) 319 (1794); *Cooper v. Day*, 1 Rich. Eq. Rep. (S. C.) 26 (1844).

A State statute providing that every corporation operating a railroad within the State under lease shall have the lease recorded is not invalid as an interference with interstate commerce. *Commonwealth v. Chesapeake, etc. R. Co.*, 101 Ky. 159 (1897), (40 S. W. Rep. 250).

Under statutes, requiring, under penalties, the lessee in every railroad lease to have it recorded in the office of the Secretary of State, and of the county clerk of every county in which the road lies, an indictment stating the offence of operating a railway in the State under a lease without having the same recorded in said offices is sufficient.

*Commonwealth v. Chesapeake, etc. R. Co.*, 115 Ky. 57 (1903), (72 S. W. Rep. 361).

§ 196. **Corporation may be estopped from alleging Irregular Execution of Lease.** — When a railroad company, acting within the scope of its corporate powers, executes a lease of its railroad to another corporation, and permits the lessee to take possession of the leased property and make improvements thereon, or when such a railroad company takes a lease and assumes control of the leasehold estate, it is estopped to allege irregularities in its own execution of the lease.<sup>1</sup> In *Union Pacific R. Co. v. Chicago, etc. R. Co.*,<sup>2</sup> Judge Sanborn said: "Under these circumstances, to permit this company now to repudiate this contract would violate every principle of equity and fair dealing. By its presentation to the Rock Island Company of this contract and this resolution, acts apparently official, by its acceptance of a part of the benefits of the contract, by its silence for seven months while this large expenditure of money was being made in reliance on this contract, it is estopped to declare it void, either because its board of directors failed to pass a formal resolution approving it, or because its secretary failed to state in its calls that this contract would be considered at the meetings that unanimously authorized and ratified it."

As to *allegation and proof* of execution of lease see *George v. Central R., etc. Co.*, 101 Ala. 607 (1893), (14 So. Rep. 752). See also *Hawley v. Gray Bros., etc. Co.*, 106 Cal. 337 (1895), (39 Pac. Rep. 609).

A certified copy of a lease of a railroad is admissible in evidence under Illinois statutes.

*Chicago, etc. R. Co. v. Weber*, 219 Ill. 372 (1905), (76 N. E. Rep. 498).

<sup>1</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 51 Fed. 309 (1892), *affirmed* 163 U. S. 564 (1896), (16 Sup. Ct. Rep. 1173); *Humphreys v. St. Louis, etc. R. Co.*, 37 Fed. 307 (1889).

In *Pittsburgh, etc. R. Co. v. Keokuk, etc. Bridge Co.*, 131 U. S. 381 (1889), (9 Sup. Ct. Rep. 770), the Supreme Court of the United States said: "When a contract is made by any agent of a corporation in its behalf, and for a purpose authorized by its charter, and the corporation receives the benefit of the contract, without objection, it may be presumed to have authorized or ratified the contract of its agent."

<sup>2</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 51 Fed. 328 (1892), *affirmed* 163 U. S. 564 (1896), (16 Sup. Ct. Rep. 1173). Same case in Circuit Court, 47 Fed. 15 (1891).

## CHAPTER XVIII

## THE CONTRACT OF LEASE

I. *Form and Construction of Railroad Leases*

- § 197. Form of Lease.
- § 198. Consideration.
- § 199. Rule of Construction of Leases.
- § 200. Construction of Particular Leases.
- § 201. Lease for Longer Term than Existence of Corporations may be Valid.
- § 202. Partial Invalidity of Leases. Void Restrictions.
- § 203. Dependent and Independent Contracts.
- § 203a. Assignments of Leases.

II. *Covenants in Railroad Leases*

- § 204. Covenant to pay Rent. Assumption of Interest Payments.
- § 205. Covenant to pay Taxes.
- § 206. Covenant not to Assign.
- § 207. Covenant to make Repairs.
- § 208. Covenant to pay Damages and defend Suits.
- § 209. Miscellaneous Covenants.

I. *Form and Construction of Railroad Leases*

§ 197. **Form of Lease.** — The formal parts of a lease executed by a railroad company of its road and franchises generally and properly follow, so far as applicable, the form of a lease of real estate.

While any form expressing the intention of the parties may be adopted, there is an advantage in the use of the ordinary covenants and conditions in that they have acquired a recognized judicial construction.

A lease commences with the *premises*, the object of which is to state (1) the parties — the corporations, lessor and lessee — (2) the grant and (3) the description of the property leased — the railroad, franchises, appurtenances and personal property — which may be particularly set forth in the lease itself, or referred to in an attached schedule.

The *habendum* follows the premises, the object of which is to limit the grant.

After the habendum the *term* — the commencement and duration of the lease — is stated, and lastly the *reddendum*, which fixes the amount of rent to be paid, specifies the manner and form of payment, and the periods at which the payments are to be made.

Following these formal parts, the ordinary covenants, conditions and provisions of leases so far as applicable to railroads are inserted, together with any special provisions agreed upon in the particular case.<sup>1</sup>

§ 198. **Consideration.** — The consideration of a lease is the rent. The rent is due primarily to the lessee, but, in the case of an individual, he may stipulate that it be paid to another person. The stipulation does not affect the validity of the lease.

The only reason why a similar contract might not be made by the officers — or by a majority of the stockholders of a corporation — is that they are trustees for the whole body of stockholders, and may not alienate corporate property unless the accruing benefit enures to their beneficiaries. But where one railroad company owns substantially all the stock and bonds of another company, a lease of the railroad of the latter for rent to be paid to the former company is not void for want of consideration. In such a case, the rent is paid directly to the corporation ultimately entitled to it — the real owner.<sup>2</sup>

§ 199. **Rule of Construction of Leases.** — Leases of railroads being executed in pursuance of express legislative authority receive a reasonably strict construction, but the object of the construction, as in the case of other leases and contracts, is to ascertain and effectuate the intention of the parties. In ascertaining the meaning to be given to any particular clause in a lease the Court, as said by Mr. Justice Brown in *Chicago, etc. R. Co. v. Denver, etc. R. Co.*,<sup>3</sup> is “required to examine the entire contract, and may also consider the relations of the par-

<sup>1</sup> As to form of railway lease in England, when authorized, see Railway Clauses Act 1845 (8 Vict. ch. 20, § 112).

<sup>2</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.* 51 Fed. 309 (1892), *affirmed* 163 U. S. 564 (1896), (16

Sup. Ct. Rep. 1173). Same case in Circuit Court, 47 Fed. 15 (1891).

<sup>3</sup> *Chicago, etc. R. Co. v. Denver, etc. R. Co.*, 143 U. S. 609 (1892), (12 Sup. Ct. Rep. 479), *affirming* 45 Fed. 304 (1891).

ties, their connection with the subject-matter of the contract, and the circumstances under which it was signed."

When a lease consists of several distinct writings, the different provisions of all the parts must be considered in order to ascertain the intention of the parties as evidenced by the instrument as a whole. Words and expressions must be given plain meanings which the context requires in order to make, if possible, all the parts consistent.<sup>1</sup>

While the rule is that where a lease is susceptible of two constructions, that most favorable to the lessee must prevail, such rule cannot be invoked where the intention of the parties can be ascertained from the language of the instrument when examined in the light of the surrounding circumstances.<sup>2</sup>

In case of ambiguity, the court may consider the practical construction given by the parties to the particular provisions in question.<sup>3</sup>

**§ 200. Construction of Particular Leases.** — Where a lease of a railroad provided that the lessee was "to have and to hold" the demised property during the term "paying the rents and keeping and performing the covenants" therein contained, it was held that any agreements and stipulations, the keeping of which was reasonably essential to the performance by the lessee of its part of the contract, should be treated as "covenants" whether so designated or not.<sup>4</sup>

A provision in such a lease that in case the lessee corporation "shall at any time fail to pay to the lessor such sums of money as may be due under the contract, or shall fail to perform any other covenant herein, and such default or failure to perform shall continue for thirty days after written notice requiring such performance, then . . . it shall be lawful for the

<sup>1</sup> Cincinnati, etc. R. Co. v. Indiana, etc. R. Co., 44 Ohio St. 287 (1886), (7 N. E. Rep. 139, 26 Am. & Eng. R. Cas. 615).

<sup>2</sup> Père Marquette R. Co. v. Wabash R. Co., 141 Mich. 215 (1905), (104 N. W. Rep. 650).

<sup>3</sup> Chicago, etc. R. Co. v. Denver, etc. R. Co., 46 Fed. 145 (1890), s. c. 143 U. S. 596 (1892), (12 Sup. Ct. Rep. 479), 45 Fed. 304 (1891).

<sup>4</sup> South Carolina, etc. R. Co. v. Augusta, etc. R. Co., 111 Ga. 420 (1900), (36 S. E. Rep. 593).

A demise of a street railway not in existence and the right to construct which depends upon the obtaining of consents from abutting proprietors is an executory contract. Atlantic Ave. R. Co. v. Johnson, 134 N. Y. 375 (1892), (31 N. E. Rep. 903).



[lessor], at its option, to reënter," gives the lessor, upon a breach by the lessee of any agreement or stipulation, the right to enforce the forfeiture of the lease.<sup>1</sup>

Where a lease provided that, upon its expiration, the lessee should return the road in as good condition as when received, and where, under a statute, failure to operate the road would work a forfeiture of the lessor's charter, it was held that the lessee was bound to keep the road in operation.<sup>2</sup>

A railroad company demised its railroad and railroad property of every description "including" its railroad, rights and appurtenances; "and also" all buildings and equipment and all personal property belonging to it; "and also" all franchises, etc. It was held that the words "and also" related back to the words of demise and were not restrained by the word "including" to distinctively railroad property.<sup>3</sup>

A provision in a lease that the lessee shall pay a definite sum for the expenses of keeping up the organization of the lessor imposes an obligation of a specific nature which the lessee is bound to perform, and against which it cannot set off the amount of a judgment which it holds against the lessor.<sup>4</sup>

<sup>1</sup> South Carolina, etc. R. Co. v. Augusta, etc. R. Co., 111 Ga. 420 (1900), (36 S. E. Rep. 593).

<sup>2</sup> Southern R. Co. v. Franklin, etc. R. Co., 96 Va. 693 (1899), (32 S. E. Rep. 485, 44 L. R. A. 297).

<sup>3</sup> Gray v. Massachusetts Cent. R. Co., 171 Mass. 116 (1898), (50 N. E. Rep. 549).

One railroad company granted to another the right in perpetuity to use in common with itself a portion of its road. This contract was held to be a lease. The contract contained stipulations concerning the character of the business to be done upon the road, but provided that such stipulations should not apply in case the lessee made a certain extension of its lines. It was held that a purchasing corporation did not take the lessee's rights free from the restrictions, although its own lines were extended to the designated points.

Michigan Central R. Co. v. Père Marquette R. Co., 128 Mich. 333 (1901), (87 N. W. Rep. 271).

<sup>4</sup> Louisville, etc. R. Co. v. Cumberland, etc. R. Co., 21 Ky. Law Rep. 1126 (1900), (54 S. W. Rep. 5); rehearing denied, 21 Ky. Law Rep. 140 (1900), (55 S. W. Rep. 884).

In a street railway lease the lessee agreed to pay an annual rental; to operate the railway at its own expense and make necessary repairs; to pay the floating debt of the lessor and all assessments, and to apply all moneys not required for current liabilities or interest to the improvement of the leased property. It was held that the lessor was not bound to turn over to the lessee any moneys received by it and that the rent paid by the lessee would not be repaid to it.

Moorshead v. United Rys. Co., 119 Mo. App. 541 (1906), (96 S. W.

The phrase "terminal facilities," as understood by persons operating railroads, includes only tracks used in making up trains. A lease of such facilities does not include a track used only for the purpose of reaching car works.<sup>1</sup>

§ 201. **Lease for Longer Term than Existence of Corporations may be valid.** — A lease for a time certain provided the lessee live so long is valid, and, extending this principle, it has been held that a lease to a railroad company for nine hundred and ninety-nine years is not invalid although the charter of the corporation will expire long before the termination of the lease, for the reason that the existence of the corporation *may* be prolonged by law for the entire term.<sup>2</sup> *A fortiori* is this

Rep. 261), *affirmed* 203 Mo. 121 (1907), (100 S. W. Rep. 611).

A railroad company agreed with another company to construct and build its road with suitable terminals at a designated city and immediately thereafter took a lease of the road, for a period of ninety-nine years with power to complete it as previously agreed upon, at a fixed rental, and with a further provision that all taxes upon the property and franchises of the lessor might be paid by the lessee but should be deducted from the rent. The lessee purchased real estate outside but adjoining the lessor's location at said terminal, and erected sidings and buildings thereon. It was held that the lessee had no right to deduct taxes paid upon this last-mentioned property from the rent. The lessee also paid a franchise tax assessed upon the basis of the gross earnings of all the lines operated by it within the State, divided by the total number of miles so operated. It was held that this was not a tax upon the franchises of the leased lines alone; that it was either a tax upon the lessee's franchises alone or upon its franchises and those of the leased road. In the latter case it could not be apportioned and deducted from the rent. *Lewiston, etc. R. Co. v. Grand Trunk R. Co.*,

97 Me. 261 (1903), (54 Atl. Rep. 750).

<sup>1</sup> *Jacksonville, etc. R. Co. v. Louisville, etc. R. Co.*, 47 Ill. App. 414 (1893).

The rights of a railroad company under a lease of terminal facilities from a station company cannot be affected by a subsequent lease executed by the station company to another railroad company. *Père Marquette R. Co. v. Wabash R. Co.*, 141 Mich. 215 (1905), (104 N. W. 650).

See this case also for examination of many questions relating to terminal agreements.

For construction of a series of leases and renewals between a terminal company and its constituent corporations as tenants — rental being paid on a wheelage basis — see *Grand Trunk West. R. Co. v. Chicago, etc. R. Co.*, 141 Fed. 785, (1905).

<sup>2</sup> *Hill v. Atlantic, etc. R. Co.*, 143 N. C. 241 (1906), (55 S. E. Rep. 854): "Where the term of a lease of the property of a railroad company extends beyond the time fixed by its charter for the corporate existence of the lessor, such a lease is valid for the period of the corporate life of the lessor, and will extend beyond that period if the charter is renewed,

principle applicable in a case where the lease provides that it shall bind the successors and assigns of the parties thereto and the charter of the lessee corporation contains a provision for its continued renewal. As said by Judge Sanborn in *Union Pacific R. Co. v. Chicago, etc. R. Co.*<sup>1</sup> "The contingency that this corporation will cease to exist, and leave neither assigns nor successors, is far too remote to have any influence upon the validity of this contract."

Upon the same principle, a lease *by* a corporation for a longer period than its own existence is not void where the laws of the State creating the corporation permit an extension of its charter.<sup>2</sup>

§ 202. **Partial Invalidity of Leases. Void Restrictions.**—A conveyance of property which a corporation is authorized to make is not rendered wholly void by including therein property and franchises which the corporation is without authority to alienate. It is valid as to the former property and invalid as to the latter.<sup>3</sup> This principle is applicable to leases.

A lessor railroad corporation can impose upon the use of its railroad by the lessee only such restrictions as are consistent with the discharge by the lessee of those obligations which, as common carrier and otherwise, it owes to the State and to the public. In *Metropolitan Trust Co. v. Columbus, etc. R. Co.*,<sup>4</sup> Judge Taft said: "Restrictions in the nature of conditions subsequent, which in respect to the demised premises forbid the lessee to do its public duties as a common carrier, would, if enforced, prevent the lessee from enjoying the demised premises at all in a lawful manner, and are, therefore, repugnant

and by this process it may endure for the full term."

<sup>1</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 51 Fed. 329 (1892). *Affirmed* 163 U. S. 592 (1895), (16 Sup. Ct. Rep. 1173), where the language of Judge Sanborn stated in the text is quoted with approval by Chief Justice Fuller. The contract denominated a "lease" in this case was really a trackage contract, but the principles are equally applicable to a lease.

<sup>2</sup> *Gere v. New York Central, etc. R. Co.*, 19 Abb. N. C. 193 (1885).

A railroad company cannot prolong its existence, which depends upon the *user* of its franchises, by leasing them to another corporation which uses them for its own benefit. *Re Brooklyn, etc. R. Co.*, 81 N. Y. 69 (1881).

<sup>3</sup> *Butler v. Raben*, 46 Md. 541 (1877); *Hendee v. Pinkerton*, 14 Allen (Mass.) 381 (1867); *Gloninger v. Pittsburgh, etc. R. Co.*, 139 Pa. St. 13 (1891), (21 Atl. Rep. 211).

<sup>4</sup> *Metropolitan Trust Co. v. Columbus, etc. R. Co.*, 95 Fed. 22 (1899).

to the grant and void. When one takes an estate upon condition subsequent, which is void as against public policy or for any other reason, the estate continues in the lessee or grantee freed from the condition."<sup>1</sup>

§ 203. **Dependent and Independent Contracts.** — Where a contract of lease is invalid, the question whether other contracts in a measure connected with and referring to it are also void, depends upon whether such contracts are dependent upon the lease or independent of it.

While sometimes "by referring in a document signed by the party to another document, the person so signing in effect signs a document containing the terms of the one referred to"<sup>2</sup> and a contract referring to an invalid lease may fall with it, such is not always the case. The effect of a reference depends upon the language of the instrument containing it. Thus, a lease of A's railroad to B is not made dependent upon the validity and continuing existence of a lease of C's road to B by a covenant that A shall receive from B a monthly statement of the gross receipts of C's road and shall have an opportunity to inspect its books and accounts, which are, however, important only in case B seeks a reduction of the rental from the maximum amount stated in the lease.<sup>3</sup> So, it was held

<sup>1</sup> *Railroad Co. v. Mathers*, 71 Ill. 592 (1874); 1 Story Eq. Jur. § 288; 2 Washb. Real Prop. (5th ed.), 8.

<sup>2</sup> *Fitzmaurice v. Bayley*, 9 H. L. Cas. 99 (1860).

<sup>3</sup> *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 393 (1888), (23 Atl. Rep. 529), where Doe, C. J., said (p. 402): "There has been no breach of the express covenant to pay rent, or the express agreement to render to the plaintiffs a statement of the gross receipts of the five roads, or the express covenant that books and accounts relating to the business of the five roads shall be open to the plaintiff's inspection. But the lease of the Northern and its branches to the defendants has been judicially annulled; and the plaintiffs contend that upon the validity and continuing existence of that lease the Montreal

lease was made dependent. If the parties had intended this lease should terminate in case the Lowell voluntarily or involuntarily ceased to operate or control the Northern, their accidental failure to put that important part of their contract in the lease could have been cured in a suit for the reformation of the defective instrument. In the lease there is no express stipulation of that kind, and no evidence on which it can be found that such a condition (which would naturally be expressed in direct and distinct terms) was intentionally left to be implied from the mode in which the lessees are to ascertain and show the amount of rent to be paid if they seek to avoid the payment of the largest sum named in the contract. . . . The lease of the Montreal was not made dependent upon the valid-

that a bridge contract, referring to certain articles in a lease for the purpose of defining the extent of liabilities and benefits assumed, did not make the bridge contract a part of the lease. The validity of the contract was entirely independent of the validity or invalidity of the lease.<sup>1</sup>

§ 203a. **Assignments of Leases.** — Where there is no covenant not to assign in a lease of a railroad the lessee corporation may assign it to another corporation authorized to take it, and the rights of the three parties — lessor, lessee and assignee — will be governed by principles similar to those applicable in the case of ordinary assignments of leases. Where possession of the leased property is taken without an express covenant to assume the rent, the assignee is liable for it through privity of estate. Where the assignee promises to pay the rental it is liable through privity of contract.

No particular form is necessary for the assignment of a railroad lease.<sup>2</sup> Thus where a lessee of a railroad itself executed a lease of all the property embraced therein to another corporation, it was held to operate as an assignment of the original lease for its entire term.<sup>3</sup>

ity and continuing existence of the lease of the Northern.”

<sup>1</sup> *Railway Co. v. Keokuk Bridge Co.*, 131 U. S. 371 (1889), (9 Sup. Ct. Rep. 770, 39 Am. & Eng. R. Cas. 213).

<sup>2</sup> *Frank v. New York, etc. R. Co.*, 122 N. Y. 197 (1890), (25 N. E. Rep. 332).

Where a lessee sold the right to use and possess the leased property as long as the lessee could, the rent to be paid to the lessee and the lessee to pay lessor, it was held that the arrangement was, in legal effect, an assignment of the lease. *Indianapolis Mfg. Union v. Cleveland, etc. R. Co.*, 45 Ind. 281 (1873).

A contract whereby a railroad company — lessee of a railroad — agrees with another company for the operation of the leased road, the latter company receiving the income, paying the expenses and fixed charges and turning over the surplus to the

former company, is an operating contract and not an assignment of the lease.

*St. Joseph, etc. R. Co. v. St. Louis, etc. R. Co.*, 135 Mo. 173 (1896), (36 S. W. Rep. 602, 33 L. R. A. 607).

<sup>3</sup> *Frank v. New York, etc. R. Co.*, 122 N. Y. 197, 214 (1890), (25 N. E. Rep. 332): “By the agreement . . . a leasehold estate was carved out of the fee belonging to the former, and the consideration agreed to be paid therefor by the latter was the rent reserved, although in an unusual form. As the lease from Woodruff to the Erie Company embraced all that he had acquired from his lessor, it operated as an assignment in fact, although not such in form, of the entire term granted by the original lease. Thenceforward the legal relations of the three parties named were those of lessor, lessee and assignee under a lease. The Erie

The lessor, lessee and assignee of a lease of a railroad may modify its provisions and reduce the rent, notwithstanding there is a mortgage upon the road, where there is no covenant on the part of the assignee for the benefit of the mortgagee.<sup>1</sup>

The assignee of a railroad lease may be required, in equity, to specifically perform its terms.<sup>2</sup>

## II. *Covenants in Railroad Leases*

§ 204. **Covenant to pay Rent. Assumption of Interest Payments.** — A lessee is liable for rent during his occupancy without an express covenant to pay it, and, therefore, the special covenant to pay rent may be termed a precautionary covenant, since its office is to prevent a lessee from assigning his lease perhaps to an irresponsible person and thereby releasing himself from further responsibility. When such special covenant appears in a lease a lessor has double security. There is priv-

Company become liable for the interest and principal, as it fell due, both by privity of contract and by privity of estate. The former liability depended upon its express promise to pay, whether it entered into possession or not, and could be discharged only by payment, while the latter depended upon entry into possession under the lease, and could be avoided by assigning the entire term and relinquishing possession."

<sup>1</sup> *Frank v. New York, etc. R. Co.*, 122 N. Y. 197 (1890), (25 N. E. Rep. 332): "It is clear that, ordinarily, the lessor, lessee and assignee of a lease may modify its terms by reducing the amount of rent. Can they do so when there is a mortgage upon the property covered by the lease, but not upon the leasehold estate itself? Why can they not in the absence of fraud and when, as in this case, there is no covenant on the part of the assignee for the benefit of the mortgagee? Without such a covenant, or some express promise, the assignee of a lease is under no more obligation to the mortgagee of a

lessor, than a grantee is to the mortgagee of a grantor."

<sup>2</sup> One railroad company purchased all the property of another railroad company, including a lease held by it of still another railroad, and took charge of and operated the latter road for a long time. It then brought suit to recover from the lessor corporation under said lease sums of money due to the said selling corporation — the original lessee — under the terms of the lease. It was held that such purchasing corporation thereby assumed the obligation of the selling corporation under the lease and was not a tenant by sufferance, and that specific performance of the terms of the lease by it would be adjudged, notwithstanding the original lessor had failed to perform its undertaking to provide means for completing the construction of the road.

*Schmidt v. Louisville, etc. R. Co.*, 101 Ky. 441 (1897), (41 S. W. Rep. 1015, 38 L. R. A. 809). See also *Southern R. Co. v. Franklin, etc. R. Co.*, 96 Va. 693 (1899), (33 S. E. Rep. 485, 44 L. R. A. 297).

ity of estate between him and the assignee ; privity of contract between him and the lessee.

This covenant has a proper place in railroad leases and may contain provisions for the payment of rent in various ways and forms. It may stipulate that a fixed sum shall be paid at stated intervals; that prescribed dividends on the shares of the lessor corporation shall be provided for; or that a portion of the gross or net earnings arising from the operation of the leased railroad shall be turned over to the lessee or expended in its behalf. Thus, under a statute authorizing railroad companies to lease and operate the roads of other companies, a covenant in a lease by which the lessee, in lieu of directly paying rent, guaranteed the payment of interest accruing upon bonds of the lessor was held valid.<sup>1</sup> Where such a covenant takes

<sup>1</sup> *Eastern Townships Bank v. St. Johnsbury, etc. R. Co.*, 40 Fed. 424 (1889). Judge Wheeler said: "The laws of Vermont, under which the defendant has and exercises its corporate powers, provide that 'railroad companies in this State may make contracts and arrangements with each other, and with railroad corporations incorporated under the laws of other of the United States, or under the authority of the government of Canada, for leasing and running the roads of the respective corporations, or parts thereof, by either of their respective companies.' R. L. Vt. § 3303. This statute conferred ample power upon the defendant corporation to take the lease, and to agree to pay the rent as it should fall due, and doubtless to arrange for paying the rent, by paying coupons of the same amount or guarantying their payment."

A railroad lease provided that the lessee should pay the lessor's bond interest as a part of the annual rental; that if the lessor should pay its bonds when they matured, the lessee should pay to it a sum equal to the interest so saved, but that if the lessor should not pay them, the lessee should issue

new bonds. The lessor did not pay an issue of bonds, and the lessee refunded them at a lower rate of interest. A question arose as to which party was entitled to the benefit of the refunding, concerning which the New York Court of Appeals said (*Continental Ins. Co. v. New York and Harlem R. Co.*, 187 N. Y. 225 (1907), (79 N. E. Rep. 1026)): "The distinguished jurist before whom, as referee, this case was tried, was of the opinion that by the terms of the original lease the Harlem Company was entitled, if it could procure the necessary funds, to pay off the consolidated mortgage bonds and thus secure to itself any advantage in the reduction in the interest charged on its road. We think that in this view he was clearly right. By the first clause of the lease all payments to be made by the lessee were reserved as rent, and by the second subdivision of the clause that rent was to be paid by paying certain specific interest charged to the holder of the bonds. This provision did not change the character of the payment, but merely the method of the payment. The payment was still to be of rent."

A lease of a railroad in perpetuity

the form of an agreement to pay to the trustees of the lessor's mortgage interest thereon as it accrues, the lessee corporation is directly liable to the mortgagees therefor although they are not parties to the lease, since the agreement shows that it was intended for their benefit.<sup>1</sup>

§ 205. **Covenant to pay Taxes.** — In this country, as distinguished from England, lands and property are generally assessed in the name of the owner, so that the lessee is under no obligation to pay taxes unless he assume them as a part of the rent. Covenants wherein the lessee assumes the taxes are not

provided that the lessee should pay an annual rental of the specified sum by paying interest on certain bonds and dividends at a stated rate upon the stock. The lessee also had the right to take stock for improvements upon the road without limitation as to total amount. A sinking fund was provided for to pay off certain bonds. A supplemental agreement was entered into limiting the amount of stock to be issued and providing for a higher dividend in view of the saving of interest caused by the operation of the sinking fund. The bonded debt was refunded at its maturity at a lower rate of interest. The Circuit Court held that the lessor was entitled to the benefit of the saving by the refunding.

*Ætna Ins. Co. v. Albany, etc. R. Co.*, 156 Fed. 132 (1907). The appeal in this case to the United States Circuit Court of Appeals has not yet been decided.

<sup>1</sup> *Welden Nat. Bank v. Smith*, 86 Fed. 398 (1898), s. c. *sub nom. Grand Trunk R. Co. v. Central Vermont R. Co.*, 78 Fed. 690 (1897). In this case where a lessee under a railroad lease covenanted to pay all obligations of the lessor incurred "as common carriers, warehousemen, or otherwise," and thereafter to pay the interest on certain mortgage bonds of the lessor, it was held, that "or otherwise" referred only to obligations of the same class as those

enumerated, and that earnings accruing in the hands of receivers of the lessee were applicable to interest on the bonds, rather than to judgments on claims not falling within that class.

In *Day v. Ogdensburgh, etc. R. Co.*, 107 N. Y. 129 (1887), (13 N. E. Rep. 765), an agreement between two railroad companies and others provided that one company should issue so many of its first mortgage bonds, not exceeding a sum specified, as should be sufficient to construct its road; that these should be purchased by the parties to the agreement, other than the two corporations. Defendant corporation agreed when the road was completed to take a lease of it on terms and conditions specified. After the completion of the road a lease was executed as agreed upon. By the terms of the lease defendant agreed to maintain and operate the demised road as a part of its line, to pay taxes and certain other expenses, and to pay at maturity the principal and interest of the bonds; also, that the gross earnings of the road should be applied, first, to pay the interest accruing, and second, for the creation of a sinking fund for the payment of the principal of the bonds. It was held that the agreement and lease were within the power of the two corporations to make and were valid. See *post*, § 212: "*Rights of Stockholders when Rent is payable in Form of Dividends.*"



uncommon in leases of real estate and are general in leases of railroads, although the systems of taxing that class of property vary widely in the different States.

Upon the principle that a tax, in the sense in which the word is ordinarily used, is "something exacted for public service and not by way of compensation for benefits conferred," it is held that a covenant to pay "all taxes" does not include an assessment for benefits, or other special rates of a similar nature.<sup>1</sup> The application of this principle is, however, readily and commonly avoided by the use of the phrase, "all taxes and assessments."

Where a railroad lease provided that the lessee should pay all taxes and assessments imposed during the term by any governmental or lawful authority on the railroad and leased property, or on any business, earnings or income of the same or, "by reason of the ownership thereof," it was held that the lessee was bound to pay a tax imposed upon the franchise of the lessor, it being a tax imposed "by reason of the ownership" of the road.<sup>2</sup>

A general covenant to pay all taxes relates only to future taxes imposed during the term of the lease and involves no

<sup>1</sup> Wood's *Landlord and Tenant*, p. 685, and cases there cited.

<sup>2</sup> *Thomas v. Cincinnati, etc. R. Co.*, 93 Fed. 587 (1899).

A lessee corporation which covenants to pay all taxes assessed upon "the real and personal property, franchises, capital stock or gross receipts" of the lessor during the term is not bound to pay a tax levied on "dividends." *Jersey City Gas Light Co. v. United Gas Imp. Co.*, 58 Fed. 323 (1893), s. c. 46 Fed. 264 (1891).

Where a lease provided that the lessor should pay "all taxes now or hereinafter imposed by law upon the property hereby demised and the earnings from or business thereof" it was held that the covenant would not be construed to cover a tax on the capital stock of the lessor, particularly as the parties for many years had acted under the contrary interpreta-

tion. The Court said: "The lease sued on did not stipulate for the payment by the lessee of all taxes imposed on the lessor company, but of all taxes on the property demised and was so understood and acted upon by the parties for thirty years."

*Erie, etc. R. Co. v. Pennsylvania R. Co.*, 208 Pa. 506 (1904), (57 Atl. Rep. 980).

Where the lessee of a railroad was to pay all taxes and deduct them from the rent, it had no right to deduct taxes upon land which it had itself purchased outside the lessor's location and used for sidings and buildings in connection with the railroad; nor could it deduct a franchise tax which was incapable of apportionment as against the lessor.

*Lewiston, etc. R. Co. v. Grand Trunk R. Co.*, 97 Me. 261 (1903), (54 Atl. Rep. 750).

assumption of past due taxes. Thus, a covenant by the lessee in a railroad lease that it "will pay, as operating expenses, all taxes and assessments . . . which may be lawfully levied or assessed" upon the demised property, is not an assumption of liability for taxes already assessed and levied.<sup>1</sup>

The covenant to pay taxes and assessments is for the sole benefit of the lessor corporation. It confers no right of action against the lessee in favor of the municipality levying the assessment, because there is no privity between them.<sup>2</sup>

§ 206. **Covenant not to Assign.** — The covenant not to assign or sublet the demised premises without the written consent of the lessor used in ordinary leases of real estate is generally inserted in railroad leases, and is of the utmost importance when so employed, in safe-guarding the interests of the lessor corporation. As observed by Judge Clark in *Boston, etc. R. Co. v. Boston, etc. R. Co.*<sup>3</sup>: "The lessor had the right to choose its tenant, and, whatever may have been its purpose in doing it, the conclusion is irresistible that the stipulation against assigning, underletting or parting with the possession of the demised premises, was inserted in the lease to secure the exercise of the personal integrity, discretion, and judgment of

<sup>1</sup> If there is any contract implied by law whereby one railroad company, acquiring the control of the property, income, etc., of another, becomes directly liable for taxes already due, and constituting a lien thereon, for the fiscal year then current, such liability is only in proportion to the part of the fiscal year remaining after the assumption of such control. *Cleveland v. Spencer*, 73 Fed. 559 (1896).

A railroad company leased part of its road to another company, which agreed to pay all taxes assessed against the leased property. Under the statute, taxes on the leased line were assessed against the lessor, as owner, in the same manner as the taxes upon the part of its road not leased, and were paid, reimbursement being made by the lessee. The assess-

ment upon the property of the lessor, including the leased line, having been raised, it was contested, but, after extended litigation, was sustained. In the meantime, receivers had been appointed for the lessee, and they took possession of the leased line and paid other taxes through the issue of receivers' certificates. It was held that they were bound to repay to the lessor the proper proportion of the judgment for the contested taxes. *United States Trust Co. v. Mercantile Co.*, 88 Fed. 140 (1898).

<sup>2</sup> *Chicago, etc. R. Co. v. City of Ottumwa*, 112 Iowa, 300 (1900), (83 N. W. Rep. 1074, 51 L. R. A. 763).

<sup>3</sup> *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 448 (1888), (23 Atl. Rep. 529).

the lessee, in shaping the policy and controlling the management and operation of the road."

Therefore, when a lessee corporation voluntarily parts with its power to control the operation of the railroad leased and becomes the mere agent of a third corporation in the operation of the road, the covenant not to assign is broken in substance and the estate granted by the lease is forfeited.<sup>1</sup>

The covenant not to assign as usually drawn, however, is, under certain conditions, of no benefit to the lessor corporation and may be broken by indirection without incurring a forfeiture. Thus, upon the principle that a mortgage, outside of the New England States, is not a transfer of the legal title or possession, it is held that the giving of a mortgage of a leasehold interest without the consent of the lessor is not a violation of the covenant not to assign; and, upon the further principle that an assignment or transfer, *by operation of law*, does not constitute a breach of the covenant, it is held that a sale of the leasehold interest in foreclosure proceedings is not a breach because it is *in invitum*.<sup>2</sup> A lessee railroad company may, therefore, mortgage its lease and the leasehold interest may be sold to a corporation objectionable to the lessor without a breach of the covenant not to assign. The position of the lessor may be protected, however, by providing in the covenant that the lease hold interest shall not be mortgaged without the lessor's consent, or by adding a provision that the

<sup>1</sup> A covenant by the lessee of a railroad not to assign the lease is broken by its assignment of the future gross earnings of the road to a third person and contracting to use and operate it under the direction of the assignee. *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 393 (1888), (23 Atl. Rep. 529).

The assignee of the lease of a railroad cannot take advantage of the fact that the lease was not consented to by the lessor corporation as required by its terms. *Schmidt v. Louisville, etc. R. Co.*, 101 Ky. 441 (1897), (41 S. W. Rep. 1015, 38 L. R. A. 809).

<sup>2</sup> *Riggs v. Pursell*, 66 N. Y. 193 (1876). This decision is expressly put upon the ground (p. 200) that "a mortgage in this State of land is not a transfer of the legal title, or the possession, but a mere security," citing *Trimm v. Marsh*, 54 N. Y. 599 (1874), (13 Am. Rep. 623), where the New York rule, as distinguished from the rule in England and the New England States, is discussed at length. It may, therefore, be doubtful whether a mortgage in those States where it is regarded, between the parties, as a conveyance of the fee, would not constitute a breach of the covenant not to assign.

lessor may terminate the lease if transferred by operation of law.

The general rules of law relating to this covenant, as, for example, that where consent has once been given to an assignment the restriction is gone forever, and that the lessor may waive the forfeiture occasioned by a breach of the covenant by accepting rent,<sup>1</sup> are applicable to leases of railroads only as they apply to leases in general, and are fully considered in treatises upon the general subject of the relation of landlord and tenant.

§ 207. **Covenant to make Repairs.** — The covenant upon the part of the lessee corporation to make repairs is usually inserted in railroad leases. It often appears in conjunction with the covenant — of an analogous nature — to preserve the leased personal property and to substitute new for old.

A covenant in a railroad lease that the lessee corporation shall "return said road and property, both real and personal, at the termination of this lease, in as good condition and repair in all respects as it is now in, natural wear only excepted," binds the lessee to keep the road in good running condition, and to renew all structures which by decay or accident become unsafe.<sup>2</sup>

<sup>1</sup> A lessor corporation may waive a breach of a covenant not to assign or sublet, by acquiescing and by failing to object within a reasonable time when the leased property is turned over to another without its consent. "The Elevator Case," 17 Fed. 200 (1881).

Where a lease contains a covenant not to assign without the written consent of the lessor, the assignee is chargeable with notice of its terms, and if rent is not accepted after an assignment the lessor is not estopped from claiming a forfeiture.

Indianapolis Mfg. Union v. Cleveland, etc. R. Co., 45 Ind. 281 (1873).

<sup>2</sup> Sturges v. Knapp, 31 Vt. 1 (1858). See also Southern R. Co. v. Franklin, etc. R. Co., 96 Va. 693 (1899), (32 S. E. Rep. 485, 44 L. R. A. 297).

Notwithstanding a covenant to re-

store the leased railroad in good repair at the termination of the lease is qualified by the words, "unless prevented by unavoidable casualty, legal proceedings or operation of law," a lessee is bound to turn over the property in good repair, where the lease is terminated by a sale in foreclosure proceedings. It was also held in this case that a trustee under a mortgage to secure the bondholders of the lessor corporation might sue the lessee upon such a covenant, the undertaking being, according to the agreement, for the benefit of the bondholders.

Louisville, etc. R. Co. v. Schmidt, 112 Ky. 717 (1902), (66 S. W. Rep. 629).

For consideration of the rights of a trustee for bondholders in a suit against a lessee corporation for failure

Under a covenant in a lease to make "necessary repairs," it has been held that a lessee is obliged only to make such repairs as its own use of the premises requires. In so holding the Court said: "The word 'necessary' applied to repairs, may well be understood to denote such repairs as were necessary to the defendants, and not such as might be necessary for some future or different use of the property, after their lease had expired."<sup>1</sup>

§ 208. **Covenant to pay Damages and defend Suits.** — While upon considerations of public policy the courts of several States hold that a lessor railroad company cannot by leasing its railroad, even with legislative sanction, absolve itself from liability to third persons for the negligence of the lessee in the operation of the road, and while it is unquestioned that the liability of the lessor for the proper discharge of its primary obligations continues after a lease as before, yet as between themselves the liability to pay damages and the obligation to defend suits may be the subject of agreement between the lessor and lessee, and covenants relating thereto are usual in railroad leases. "Similar provisions," said Judge Brawley in a recent case,<sup>2</sup> "will doubtless be found in every contract whereby one railroad company undertakes to lease or operate another. Suits, actions, or damages are incidental to the operation of every railroad, and provision must always be made whereby one or the other of the contracting corporations assumes such burdens."

to keep the roadbed of a leased road in repair as stipulated in the lease, see *First National Bank v. Louisville, etc. R. Co.* (Ky. 1904), 79 S. W. Rep. 280. In this case it was also held that the fact that the lessee denied any obligation to keep the road in repair did not prevent its recovering back, as one of the bondholders, its proportionate share of what it was obliged to pay as lessee.

<sup>1</sup> *White v. Albany R. Co.*, 17 Hun (N. Y.), 98 (1879).

<sup>2</sup> *South Carolina, etc. R. Co. v. Carolina, etc. R. Co.*, 93 Fed. 557 (1899). See also *Stephens v. Southern Pacific Co.*, 109 Cal. 86 (1896),

(41 Pac. Rep. 783, 50 Am. St. Rep. 17, 29 L. R. A. 751).

A lease by a railroad company of a portion of its right of way, upon condition that the company shall not be liable for any damage to buildings or personal property situated thereon, by reason of fire originating from its locomotives, or for damages resulting from the negligence of its employees or agents, is not void, as against public policy, either under the Iowa decisions or upon general principles. *Hartford Fire Ins. Co. v. Chicago, etc. R. Co.*, 70 Fed. 201 (1895), (30 L. R. A. 193).

As the corporations — lessor and lessee — stand upon the same plane, such covenants as they may agree upon regarding the assumption of liabilities are not opposed to public policy, and are valid and enforceable.

§ 209. **Miscellaneous Covenants.** — In addition to the covenants already considered, the contracting parties to a railroad lease authorized by legislative authority have, as incident to the power conferred, the right to include in the lease such other covenants usual in leases as may be agreed upon in the particular case.<sup>1</sup> Thus, a corporation authorized to lease a building may covenant to keep it insured;<sup>2</sup> and a railroad company as lessee may properly covenant “to use all proper and reasonable means to maintain and increase the business” of the leased railroad.<sup>3</sup>

<sup>1</sup> *Abby v. Billups*, 35 Miss. 618 (1858), (72 Am. Dec. 143).

An arbitration clause in a railroad lease providing that in case of dispute each party “shall select a referee of experience and skill in railroad management, and the said referees shall select another of like skill and experience” is valid and is not rendered unlawful by the fact that the lessee company owns a majority of the stock of the lessor company.

*Wolf v. Pennsylvania R. Co.*, 195 Pa. St. 91 (1900), (45 Atl. Rep. 936).

<sup>2</sup> A corporation with power to lease a building may, in consideration of the lessor’s obligation to rebuild in case the building should be burned down, covenant to keep the same insured. *Jacksonville, etc. R. Co. v. Hooper*, 160 U. S. 514 (1896), (16 Sup. Ct. Rep. 379).

<sup>3</sup> Where a lessee corporation entered into such a covenant and subsequently became the practical owner of another railroad having the same general direction as the leased road and practically the same terminals, it was held that while the lessee had no right to violate either the letter or spirit of the lease, yet that the cove-

nant was not broken by shipping freight over its parallel road, where the carrying of such freight over the leased road would have been impracticable on account of its heavy grades.

*Catawissa R. Co. v. Philadelphia, etc. R. Co.*, 168 Pa. St. 544 (1894), (32 Atl. Rep. 62).

A railroad company leased to another company the right to use a portion of its road for ninety-nine years, renewable forever. The lease provided that the lessee should not extend its road into certain coal territory, or receive coal for transportation from any connecting lines, and that, in case of violation of such conditions, the right of the lessee to use the demised road should be suspended during its continuance. The successor of the lessee acquired, by purchase, certain connecting lines extending into the prohibited territory, which it operated in connection with its original road for nine years, without objection from the lessor. *Held*, that conceding the provision against extension to have been valid, it was waived by the lessor by acquiescence, and with it the right to object to the transportation by the lessee of coal received for shipment on its purchased

## CHAPTER XIX

## RIGHTS AND LIABILITIES OF LESSOR CORPORATION

*I. Rights and Remedies of Lessor Corporation*

- § 210. Lessor Corporation retains Prerogative Powers — Right of Eminent Domain.
- § 211. Rights of Lessor when entitled to Share of Earnings — Equitable Lien.
- § 212. Rights of Stockholders when Rent is payable in Form of Dividends.
- § 213. Mortgage of Rent Charge.
- § 214. Remedies of Lessor Corporation.

*II. Liabilities of Lessor Corporation*

- § 215. Obligations of Lessor Corporation to State.
- § 216. Lessor Corporation cannot avoid Statutory Obligations unless exempted.
- § 217. Lessor cannot avoid Primary Obligations unless exempted.
- § 218. Liability of Lessor for Negligent Operation of Railroad — (A) Under Unauthorized Lease.
- § 219. Liability of Lessor for Negligent Operation of Railroad — (B) Under Authorized Lease.
- § 220. Liability of Lessor for Negligent Operation of Railroad — (C) To Employees of Lessee.
- § 221. Liability of Lessor for Negligent Operation of Railroad — (D) When it shares in Control.
- § 222. Liability of Lessor upon Contracts of Lessee.
- § 223. Liability of Lessor for Reconstruction and Repairs.
- § 224. Taxation of Leased Railroads.

*I. Rights and Remedies of Lessor Corporation*

§ 210. **Lessor Corporation retains Prerogative Powers — Right of Eminent Domain.** — A lease of a railroad executed with legislative sanction carries with it the right to exercise the franchises necessary for its maintenance and operation.<sup>1</sup> Extraordinary powers and privileges are, however, not included unless the State expressly approve their transfer and the lease clearly embrace them.

As a general rule, a lessor corporation retains its prerogative powers.<sup>2</sup> Thus, the lease of a railroad does not divest a

lines. Metropolitan Trust Co. v. Columbus, etc. R. Co., 95 Fed. 18 (1899).

<sup>1</sup> See ante, § 157: "*Essential Franchises pass upon Sale of Railroad.*"

<sup>2</sup> A street railway company which

lessor corporation of the right of eminent domain. The same necessity for taking lands may exist when a railroad is in the hands of a lessee as when in the hands of its owner, and pending condemnation proceedings are not abrogated by a lease but may be continued in the name of the lessor.<sup>1</sup>

As the right of eminent domain remains in the lessor, it cannot, manifestly, be exercised by the lessee in its own name,<sup>2</sup> although when duly authorized the lessee may institute and prosecute condemnation proceedings in the name of the lessor, but for its own benefit.<sup>3</sup> These principles do not prevent a lessee

has leased its property to another company for 999 years, and practically all of the stock of which is owned by the latter company, has no standing to maintain a suit in equity against a third corporation to restrain an alleged unlawful use of its tracks, especially where it has failed to object to such use for fourteen years.

*South Side Pass. R. Co. v. Second Ave. Pass. R. Co.*, 191 Pa. St. 492 (1899), (43 Atl. Rep. 346).

<sup>1</sup> *Kip v. New York, etc. R. Co.*, 67 N. Y. 229 (1876), *per* Church, J.: "In the supplemental complaint the plaintiffs allege the leasing of the defendant's road and property to the New York Central and Hudson River Railroad Company for 401 years, and claim that such lease operated to abrogate the pending proceedings to condemn the land in question, and terminated and removed all necessity for the acquisition thereof for the corporate use of the defendant. In this I think the learned counsel for the defendant is mistaken. The lease did not affect the defendant corporation in its relation to the State. The same necessity existed for the land proposed to be condemned after as before the lease for the purpose of the defendant as a corporation."

See also *Matter of Petition of New York, etc. R. Co.*, 99 N. Y. 21 (1885) (1 N. E. Rep. 27).

In *Chicago, etc. R. Co. v. Illinois*

*Central R. Co.*, 113 Ill. 156 (1885), it was held that it was immaterial that the increase of the right of way for which property was sought to be condemned, was occasioned by the use of the road by a lessee; that the use was a public use, and that the need of the lessee was that of the lessor.

<sup>2</sup> *Mayor, etc. of Worcester v. Norwich, etc. R. Co.*, 109 Mass. 113 (1871): "None of these leases or assignments can be construed to extend to the lessees or assignees the power to exercise the right of eminent domain, or to restrict the right of the legislature to alter or repeal the charters. Their rights are subordinate to that right; and if the legislature shall see fit to exercise it, they are not bound to give notice to any of these parties. . . . The lease by the Norwich and Worcester Railroad Company did not make the lessees, or their representatives, parties to the grant of power to exercise the right of eminent domain. That right remained in the original corporation, and the legislature might properly deal with it exclusively in amending their charter."

<sup>3</sup> *Chicago, etc. R. Co. v. Illinois Central R. Co.*, 113 Ill. 156 (1885).

See also *Kip v. New York, etc. R. Co.*, 67 N. Y. 227 (1876); *Dietrichs v. Lincoln, etc. R. Co.*, 13 Neb. 361 (1882), (13 N. W. Rep. 624); *Gottschalk v. Lincoln, etc. R. Co.*, 14 Neb. 389 (1883), (15 N. W. Rep. 695).



corporation from exercising in its own name, for proper purposes, the power of eminent domain conferred upon it by statute. In such a case, it exercises an original and not a derivative power which *might* be broad enough to authorize the condemnation of lands connected with the lessor's road.<sup>1</sup>

§ 211. **Rights of Lessor when entitled to Share of Earnings — Equitable Lien.** — It is competent for two railroad corporations, parties to a lease of a railroad, to agree that the lessee company shall pay a fixed rental to the lessor or that the earnings of the leased road, gross or net, shall be divided in prescribed proportions between the parties.

Where the lease expressly provides that the share of the earnings payable to the lessor is in lieu of rent — a measure of the rental — or where it may be plainly inferred that such is the case, the remedies of the lessor are confined to the enforcement of the covenants of the lease. Thus, in a case where a lease provided that "as rental for the said demised premises" the lessee company should pay a percentage of its gross earnings in excess of a fixed sum to the lessor, Judge Lurton said:<sup>2</sup> "The rental is determined by the amount of gross earnings. These earnings belong to the lessee company. The complainant has no right to any specific dollar or part of a dollar."

Where, however, it is clear from the language of the lease that a division of earnings, *as earnings*, is contemplated, the duty of the lessee does not arise from its mere covenant, but the share of the lessor becomes in equity its property immediately upon its receipt by the lessee. The lessor has an equitable lien upon such share and it is held in trust by the lessee for the benefit of the lessor and may be followed in equity.<sup>3</sup>

A *Michigan* statute (P. A. 1901, p. 117, § 19 of Act. No. 80) authorizes a lessee of a railroad to institute condemnation proceedings with the consent<sup>a</sup> and in the name, of the lessor.

<sup>1</sup> Whether the lessee of a railroad can exercise the right of eminent domain to build switches and spur tracks to the leased line, which do not connect with its own line, or whether such right must be exercised by the lessor company, — *quære*.

*Chattanooga Terminal R. Co. v. Felton*, 69 Fed. 273 (1895).

It is provided by statute in *Arkansas* (S. & H. Dig. 1894, § 6342), *Ohio* (Bates' Anno. Stat. (1787-1902), § 3300), *Wyoming* (R. S. 1899, § 3206), that a lessee of a railroad may exercise the right of eminent domain.

<sup>2</sup> *New York, etc. R. Co. v. New York, etc. R. Co.*, 58 Fed. 282 (1893).

<sup>3</sup> *Terre Haute, etc. R. Co. v. Cox*, 102 Fed. 825 (1900).

In case of the appointment of a receiver for the lessee, he may be compelled to restore any portion of the earnings due the lessor and misapplied by the lessee, even if it be necessary to appropriate the earnings of the road during the receivership for that purpose.<sup>1</sup> Thus, a provision in a railroad lease that the "lessee shall, in each and every year of the term demised, pay or cause to be paid to said [lessor] in the manner and at the times hereinafter specified, thirty per centum of the gross earnings, of the demised property," provides for a division of the earnings, as such, and vests in the lessor the equitable title to its share of such earnings upon their receipt by the lessee. Where the lessee, under such a lease, has failed to pay over the lessor's share of the earnings and has mingled the same with its own funds, bondholders of the lessor, the interest on whose bonds is required by the terms of the lease to be paid from such share, are entitled to have the amount so misapplied by the lessee restored by its receiver.<sup>2</sup>

In *Bank v. Smith*, 86 Fed. 398 (1898), where the lease provided that "all gross earnings, income and receipts," should, in each year, after payment of expenses of operation be expended, among other things, for payment of interest on bonds of the lessor company, Judge Wallace said, with reference to the covenant to pay the interest upon the bonds (p. 401): It "gave to the bond holders an equitable lien upon the earnings, because the trustee could have compelled the lessee to apply the earnings to the payment of the interest."

The general principle upon which the rule stated is based is thus stated in *Pomeroy's Equity Jurisprudence* (vol. 3 (2d ed.), § 1236): "The doctrine is carried still further and applied to property not yet in being at the time when the contract is made. It is well settled that an agreement to charge, or to assign, or to give security upon, or to effect property not yet in existence, or in the ownership of the party making the contract, or property to be acquired by him in

the future, although, with the exception of one particular species of things, it creates no legal estate or interest in the things when they afterwards come into existence or are acquired by the promisor, does constitute an equitable lien upon the property so existing or acquired at a subsequent time, which is enforced in the same manner and against the same parties as a lien upon specific things existing and owned by the contracting party at the date of the contract."

<sup>1</sup> *Terre Haute, etc. R. Co. v. Cox*, 102 Fed. 825 (1900).

<sup>2</sup> In *Terre Haute, etc. R. Co. v. Cox*, 102 Fed. 833 (1900), Judge Grosscup said: "There is no word respecting rentals; there is no plain inference that the thirty per centum thus agreed upon shall be a mere measure of rentals. It is, as indisputably as language can make it, a plain division of the earnings between the parties whose properties, taken together, produce the earnings. Unless an arrangement for division of earnings, as earnings, is in law an

§ 212. **Rights of Stockholders when Rent is payable in Form of Dividends.** — A distinct provision in a lease that the lessee shall pay directly to the stockholders of the lessor corporation as rental specified dividends upon their shares, enures to their benefit and gives them individual rights of action — either at law or in equity — against the lessee.<sup>1</sup> This is upon the

impossibility, the language employed can bear no interpretation, other than a contemplated division of earnings, as earnings. . . . It is clear to us, then, that, in the case under consideration, the duty of the Indianapolis Company, in respect to the thirty per centum of gross earnings, does not arise out of its mere promise; it is an equity growing out of the conditions from which the unified railway lines arose. The division of the earnings does not rest in an intention merely to be executed in the future; it is to be regarded, in equity, as a present fact, made so by the circumstances, together with the agreement that brought about the means creating such earnings.”

<sup>1</sup> It does not follow from the fact that the stockholders as the parties beneficially interested *may* maintain an action for the recovery of dividends that the lessor corporation — the party to the contract — may not likewise bring suit to enforce it. In fact Judge Nelson, in *Pacific R. Co. v. Atlantic, etc. R. Co.*, 20 Fed. 280 (1884), said that the lessor corporation was *the* proper party to enforce a claim for unpaid dividends payable under a lease directly to the stockholders. This decision, however, in so far as it seems to deny any right in the stockholders to sue in such a case, cannot be justified upon principle. See cases cited in the note following.

A railroad company leased its railroad to another corporation for a rental which the lease provided should be distributed directly among the stockholders of the lessor in the form

of dividends. The lessee corporation went into the hands of a receiver who took possession of the leased road and operated it but paid no rental. Thereupon the lessor company intervened in the receivership proceedings and a settlement was finally arranged providing that the lessor should receive the net earnings of its road during the continuance of the receivership; that upon the reorganization of the lessee corporation the new company should assume the lease, and in addition should pay the lessor a certain sum of money. This settlement was approved by the court in the receivership proceedings and was carried out — the lessor company receiving moneys thereunder a part of which it distributed as dividends among its stockholders, and the remainder of which it used for other purposes. This action of the lessor company was approved by a majority vote of its stockholders. Some years afterwards certain stockholders of the lessor instituted proceedings against it and the new corporation upon the theory that the entire sum paid by the reorganized company for the renewal was rental and belonged to its stockholders instead of to the lessor corporation and charging that that corporation held the same in trust for the stockholders. It was, however, held that even if the entire sum paid for the renewal of the lease was rental, yet the bill showed that more than that amount had been distributed among the stockholders and accepted by them.

*Central R. etc. Co. v. Farmers Loan, etc. Co.* 112 Fed. 81 (1901).

principle that "when one person makes a promise to another for the benefit of a third person, that person may maintain an action based on such promise."<sup>1</sup>

It is essential, however, in actions depending upon this principle, that a distinct provision for the direct benefit of the third person be shown. An agreement wherein a lessee corporation guarantees the lessor a specified annual dividend upon its capital stock, free from taxes, payable to the lessor, is not a guarantee to the stockholders individually, although evidently intended to enable the lessor corporation to make that dividend to its stockholders.<sup>2</sup> Similarly, a provision in a lease that the lessee corporation shall pay to the lessor a sum equal to a fixed percentage upon its capital stock is an agreement for the direct benefit of the corporation and gives a stockholder no right of action. The rental is due and payable to the corporation. It may or may not be appropriated for the payment of dividends to stockholders.<sup>3</sup>

<sup>1</sup> *Schermerhorn v. Vanderheyden*, 1 Johns. (N. Y.) 139 (1806). See also *Welden National Bank v. Smith*, 86 Fed. 402 (1898). In *Austin v. Seligman*, 18 Fed. 522 (1883), Judge Wallace said: "The result of the better-considered decisions is that a third person may enforce a contract made by others for his benefit, whenever it is manifest from the nature or terms of the agreement that the parties intended to treat him as the person primarily interested." See also Mr. Wharton's elaborate note to this case for full consideration of the general subject and citation of many authorities.

<sup>2</sup> In *Flagg v. Manhattan R. Co.*, 10 Fed. 430 (1881), Judge Blatchford said: "The language of article 2 of the lease is that the Manhattan guarantees to the Metropolitan an annual dividend of ten per cent on the capital stock of the Metropolitan. . . . There is no agreement either by the Manhattan or the Metropolitan that these sums shall be paid to the stockholders of the Metropolitan.

. The case, therefore, is not one

of any vested right in the stockholders of the Metropolitan to the ten per cent payments."

For other cases of leases providing for the payment of rentals directly to the stockholders of the lessor corporation in the form of dividends, see *Ætna Ins. Co. v. Albany etc. R. Co.*, 156 Fed. 132 (1907); *McLeary v. Erie Tel., etc. Co.*, 38 Misc. (N. Y.) 3 (1902), (76 N. Y. Supp. 712).

<sup>3</sup> In *Beveridge v. New York Elevated R. Co.*, 112 N. Y. 24 (1889), (19 N. E. Rep. 489, 2 L. R. A. 648), the New York Court of Appeals said (*per Gray, J.*): "Regarding then, the lease itself and the so-called guaranty which is contained among its provisions, I find therein no contract made with individual stockholders, but only one made with the New York Company which stipulates for the payment of a sum of money equal to ten per cent upon the capital stock of that company. There is no contract to pay ten per cent dividends to individual stockholders upon their holdings; nor any con-

§ 213. **Mortgage of Rent Charge.** — The execution of a lease of a railroad for a limited term does not affect the right of the lessor to mortgage the remainder estate. But a perpetual lease, without a clause of reëntry for non-fulfilment of its conditions, leaves nothing in the lessor corporation but a claim against the lessee for rent.<sup>1</sup> This rent may be a charge upon the income of the leased property. In such a case, the lessor may mortgage the rent charge.<sup>2</sup>

§ 214. **Remedies of Lessor Corporation.** — The remedies of a railroad company to enforce its demands against third persons are in no way affected by the fact that it has leased its railroad.

The remedies of a railroad company, as lessor, against its lessee, to recover damages for breach of covenant or to enforce a forfeiture are, in general, those which are available to a lessor under an ordinary lease of real estate.<sup>3</sup>

Where an action at law will furnish a lessor corporation adequate relief resort cannot be had to equity.<sup>4</sup> Thus, where

tract that the New York company will pay it out in the shape of ten per cent dividends to its stockholders. Payments under that contract are to and for the lessor corporation and go into its treasury, as would any other moneys or revenues derived from, or produced by, corporate property." See also *Harkness v. Manhattan El. R. Co.*, 54 N. Y. Super. Ct. 174 (1886).

<sup>1</sup> *Hazard v. Vermont, etc. R. Co.*, 17 Fed. 753 (1883); *Vermont, etc. R. Co. v. Vermont Cent. R. Co.*, 34 Vt. 1 (1861). See also *Langdon v. Vermont, etc. R. Co.*, 54 Vt. 593 (1882).

<sup>2</sup> In *Hazard v. Vermont, etc. R. Co.*, 17 Fed. 756 (1883), Judge Wheeler said: "The disposition of the rent and the claim for it in future is the principal thing, for that represents substantially the corporate assets of the Canada company, and when that is gone the transfer or surrender of the stock would be a mere nominal formality. Power to

deal with the rent is implied in the power to make the lease and reserve the rent, which it was held the corporation had. (*Vermont, etc. R. Co. v. Vermont Cent. R. Co.*, 34 Vt. 1 (1861).) And powers necessarily implied from those expressly granted are as well granted as the express powers."

<sup>3</sup> Where a lease of a railroad contained a covenant on the part of the lessee that it would not at any time "during the continuance of said term fix or establish a rate on local freight at a higher average rate than the average tariff rate for local freight as established by the lessor at the time of the execution of the lease," but did not provide for a forfeiture for breach of such covenant, it was held that an action for damages for such breach and not to enforce a forfeiture, was the proper remedy.

*Hill v. Atlantic etc. R. Co.*, 143 N. C. 539 (1906), (55 S. E. Rep. 854).

<sup>4</sup> In *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 393 (1888),

a legal action against a responsible corporation is an adequate remedy for neglect to keep a railroad in repair, in violation of a covenant, the remedy of a receivership will be denied.<sup>1</sup>

The circumstances may be such, however, that a remedy at law will be inadequate. In such a case equity will afford relief. Thus, where a lessee railroad company covenanted to keep the line in as good repair as when received, and where its abandonment of the road before the expiration of the lease would result in loss of traffic, deterioration of the road and, possibly, forfeiture of the lessor's charter for non-user, it was held that the lessor was entitled to a mandatory injunction preventing a threatened abandonment.<sup>2</sup>

A lessor corporation has a right to reënter for condition broken, according to the terms of the lease. It may also, under such conditions, maintain ejectment and similar actions for the recovery of the possession of the leased property.

(23 Atl. Rep. 529), the Court said: "In this suit at law the rights of the parties depend upon no general or special question of an equitable, as distinguished from a legal, character. This case is a simple one of breach of contract. The Lowell agreed that if it transferred the plaintiff's road to another company the plaintiff might take it back; and the Lowell has made the transfer it agreed not to make."

<sup>1</sup> *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 65 N. H. 393 (1888), (23 Atl. Rep. 529). That a lessor railroad company has no *lien* upon the rolling stock of the lessee under the Iowa statute relating to landlord's liens, see *Trust Co. of North America v. Manhattan Trust Co.*, 77 Fed. 82 (1896).

<sup>2</sup> *Southern R. Co. v. Franklin, etc. R. Co.*, 96 Va. 693 (1899), (32 S. E. Rep. 485, 44 L. R. A. 297). In this case the Court said: "It was objected that, conceding the remedy at law to be inadequate, equity will nevertheless not compel specific performance of a contract having some years to run,

which is practically what is sought by the mandatory injunction, that requires continuous acts involving the exercise of skill and judgment. It may be admitted that the authorities are not uniform, and that there are decisions which sustain the objection, but an examination of the decided cases will disclose the fact that the great weight of authority, and especially the recent decisions of the highest respectability and influence, maintain the jurisdiction of equity in a case like that at bar. The courts are constantly called upon to exercise the very jurisdiction here called in question in operating railroads through receivers. No particular difficulty is encountered in doing so, although the operation of the road in such case requires a continuous series of acts, involving the exercise of skill and judgment; and if the court can do this through its receiver, no good reason is perceived why it may not compel a railroad company to operate a road in performance of its contract to do so."

There is a *dictum* to the effect that "when either party, lessor or lessee, claims that acts have been done which render the continuing of the relation no longer proper, such party can go into a court of equity, on general principles, and ask to have that lease set aside, cancelled and amended. . . . And the court will declare the agreement at an end, and set aside and cancelled, and will make such orders as will seem proper and right."<sup>1</sup> Courts of equity have power, within well-defined limits, to annul written instruments, but that they have any such broad power as stated in this *dictum* would probably not have been the more deliberate opinion of the learned judge who wrote it.

## II. *Liabilities of Lessor Corporation*

§ 215. **Obligations of Lessor Corporation to State.** — A lease of its railroad does not affect a railroad company in its relations with the State. Its duties as a corporation exist after the execution of a lease to the same extent as before. It must fulfil the obligations imposed by its charter and, except when relieved by the State, must discharge all the duties to the State required of railroad companies generally.<sup>2</sup>

<sup>1</sup> "The Elevator Case," 17 Fed. 204 (1881).

<sup>2</sup> In *New Hampshire* (Pub. Stat. & Sess. Laws 1901, ch. 156, § 45, p. 506), and *Texas* (Sayles' Civ. Stat. (Supp. to 1900), vol. ii., ch. 15a), it is provided that a lease shall not affect the public obligations of a lessor corporation.

An act authorizing a railroad company to lease its railroad to another corporation, and requiring the corporation lessee to be liable in the same manner as though the railway belonged to it, imposes a liability as to its leased property upon the lessee while operating it, but does not discharge the lessor corporation from its corporate liabilities.

*Chicago, etc. R. Co. v. Crane*, 113 U. S. 424 (1885), (5 Sup. Ct. Rep. 578).

A corporation upon which a public duty is imposed by its charter, cannot relieve itself of that duty by leasing its property and franchises. Upon this principle it is held that a canal company which is required to maintain sufficient bridges across its canal, and to keep them in repair, cannot relieve itself of that obligation by leasing its canal and all its property to a railroad company.

*Ryerson v. Morris Canal, etc. Co.*, 71 N. J. L. 381 (1904), (59 Atl. Rep. 29).

A railroad company owes a public duty to have the trains upon its railroad stop at stations to which tickets are sold and a lessor company is liable for a breach of that duty on the part of its lessee.

*Pickens v. Georgia R., etc. Co.*, 126 Ga. 517 (1906), (55 S. E. Rep. 171).

The right of the State, in the exercise of its reserved power, to alter, amend or repeal the charter of a railroad company, is not restricted by a lease of its railroad, and the State will deal with the lessor corporation exclusively in withdrawing or limiting any special powers or privileges theretofore granted.<sup>1</sup>

The obligation to pay taxes upon a railroad and other property, when leased, is considered in another section.<sup>2</sup>

**§ 216. Lessor Corporation cannot avoid Statutory Obligations unless exempted.** — Statutes imposing obligations upon railroad companies in safeguarding their tracks are designed to protect the interests of the public. Public safety demands their observance.

Statutes of this character are generally construed to apply as well to the lessor as to the lessee corporation. Especially is the lessor liable where the statute imposing the obligation, expressly or by necessary inference, refers to the *owner* of the railroad. The owner of a railroad cannot shift the burden of such obligations by lease, unless expressly exempted from further liability. Mere legislative consent to a lease is not sufficient.

Upon these principles, statutes providing that railroad companies shall fence their tracks and maintain cattle guards, are generally held to impose the duty upon the lessor corporation

Where a railroad company maintained its tracks in the streets of a city and was required by statute to keep the streets in repair a stated period, it was held that a provision in the lease of its line to another corporation that the lessor renounced all duty to the public vitiated the lease, and the lessor was liable for the negligence of the lessee in allowing an obstruction in the street.

*Anderson v. Union Terminal R. Co.*, 161 Mo. 411 (1900), (61 S. W. Rep. 874).

<sup>1</sup> In *Mayor, etc. of Worcester v. Norwich, etc. R. Co.*, 109 Mass. 113 (1871), the Supreme Judicial Court of Massachusetts said: "As the right of the legislature to alter, amend or repeal the charters of these corpora-

tions is absolute, and not dependent upon their consent, it is immaterial whether such consent has been given or not. Nor was notice of the appointment or the proceedings of the commissioners necessary to be given to parties not specified in the act; the terms of the act not requiring such notice. . . . All these parties have derived their interests from the original corporations to whom the power to exercise the right of eminent domain was granted, and they hold these assigned and derivative interests under expressed or implied authority granted to those corporations by the legislature."

<sup>2</sup> See *post*, § 224: "*Taxation of Leased Railroads.*"



and to render it liable for all damages occasioned by a failure to comply therewith.<sup>1</sup> The fact that the lessee corporation may also be liable does not affect the responsibility of the lessor. In *Toledo, etc. R. Co. v. Rumbold*,<sup>2</sup> the Supreme Court of Illinois said: "It was the duty of appellants to have fenced the road, and public safety demands that they should be held liable for all damages resulting from the neglect to fence it. And the same policy would require that the lessee should be responsible for presuming to use the road of another company, fenceless and unprotected. Either company would be liable for the injury."

Upon similar principles it is held that a lessor corporation — as the owner of the railroad — is liable under statutes for injuries sustained by adjoining proprietors from fires communicated by engines operated by the lessee.<sup>3</sup>

<sup>1</sup> *United States*: *Hayes v. Northern Pacific R. Co.*, 74 Fed. 279 (1896).

*California*: *Fontaine v. Southern Pacific R. Co.*, 54 Cal. 645 (1880), (1 Am. & Eng. R. Cas. 159).

*Illinois*: *East St. Louis, etc. R. Co. v. Gerber*, 82 Ill. 632 (1876); *Toledo, etc. R. Co. v. Rumbold*, 40 Ill. 143 (1866).

*Indiana*: In this State, by statute, when the lessee operates the road in the name of the lessor, both lessor and lessee are liable for live stock killed on unfenced tracks, but when the lessee operates in its own name, it is alone responsible. *Pittsburgh, etc. R. Co. v. Bolner*, 57 Ind. 572 (1877); *Pittsburgh, etc. R. Co. v. Hanon*, 60 Ind. 417 (1878); *Cincinnati, etc. R. Co. v. Bunnell*, 61 Ind. 183 (1876).

*Iowa*: *Clary v. Iowa Midland R. Co.*, 37 Iowa, 344 (1873); *Downing v. Chicago, etc. R. Co.*, 43 Iowa, 96 (1876).

*Kansas*: *St. Louis, etc. R. Co. v. Curl*, 28 Kan. 622 (1882), (11 Am. & Eng. R. Cas. 458); *Railroad Co. v. Wood*, 24 Kan. 625 (1880): "A distinction may be drawn between those statutory duties which require con-

stant action on the part of those operating the road, such as ringing the bell at every crossing, and those which, like the one in question, are of the nature of permanent improvements."

In this case a railroad company was held liable for an injury occasioned by a failure to fence its road, although the injury occurred while it was in the hands of a receiver.

*Maine*: *Whitney v. Atlantic, etc. R. Co.*, 44 Me. 362 (1857), (69 Am. Dec. 102).

In *New York*, however, the lessee and not the lessor has been held liable for injuries caused by failure to fence the road as required by statute. *Ditchett v. Spuyten Duyvil, etc. R. Co.*, 67 N. Y. 425 (1876), and *Thorne v. Lehigh Valley R. Co.*, 88 Hun (N. Y.), 141 (1895), (34 N. Y. Supp. 525, 68 N. Y. St. Rep. 308). Since 1890, however, both lessor and lessee are liable by statute. *Railroad Law 1890 and 1892*, § 32.

<sup>2</sup> *Toledo, etc. R. Co. v. Rumbold*, 40 Ill. 145 (1866).

<sup>3</sup> *Illinois*: A railroad company which has leased its road to another company, under statutory authority,

The lessor corporation is responsible even for the torts of the lessee in the operation of the road where the statute authorizing the lease contains a provision that its execution shall not exempt the lessor from any liability to which it would otherwise be subject, or other provision evidencing an intention that the lessor corporation shall remain responsible for the proper operation of the leased railroad.<sup>1</sup>

for ninety-nine years, will be liable for the destruction of property by fire caused by the negligence of the lessee, notwithstanding the legislature may have conferred upon the lessee all the power of the lessor company. There being no clause of exemption in the act of the legislature, the liability of the lessor continues. *Balsley v. St. Louis, etc. R. Co.*, 119 Ill. 68 (1886), (8 N. E. Rep. 859, 59 Am. Rep. 784). See also *Railway Co. v. Campbell*, 86 Ill. 443 (1877).

*Massachusetts*: *Ingersoll v. Stockbridge, etc. R. Co.*, 8 Allen, 438 (1864); *Davis v. Providence, etc. R. Co.*, 121 Mass. 134 (1876).

*Maine*: *Bean v. Atlantic, etc. R. Co.*, 63 Me. 295 (1873).

*Missouri*: *McCoy v. Kansas City, etc. R. Co.*, 36 Mo. App. 446 (1889).

*North Carolina*: *Aycock v. Raleigh, etc. R. Co.*, 89 N. C. 321 (1883).

In *South Carolina*, however, under a statute making a railroad company liable for damages caused by fire communicated by "its locomotive engine," it was held that a company was not liable for a fire communicated by the engine of its lessee.

*Hunter v. Columbia, etc. R. Co.*, 41 S. C. 86 (1893), (19 S. E. Rep. 197); *Lipfield v. Charlotte, etc. R. Co.*, 41 S. C. 285 (1893), (19 S. E. Rep. 497).

<sup>1</sup> *Quested v. Newburyport, etc. R. Co.*, 127 Mass. 204 (1879); *Stearns v. Atlantic, etc. R. Co.*, 46 Me. 95 (1858); *Fort Wayne, etc. R. Co. v. Heinebaugh*, 43 Ind. 354 (1873).

Under a statute providing that a railroad company of the State leasing its road to a company organized

under the laws of another State "shall remain liable as if it operated the road itself," it has been held that the lessor company is liable not only for a breach by the lessee of its duty as a common carrier, but of its obligation as a master to its employees; that, consequently, the lessor is liable for injuries received by the lessor's servants due to its negligence.

*Markey v. Louisiana, etc. R. Co.*, 185 Mo. 348 (1904), (84 S. W. Rep. 61). In this case the Court said: "The language of that reservation is so comprehensive that if it does not cover this case it is difficult to see how it could be amended to embrace a case exactly like the case at bar, unless general terms should be discarded as ineffectual, and resort be had to the enumeration of the kind of cases in which the lessor should be held answerable." See also *Keller v. Kansas City, etc. R. Co.*, 135 Fed. 204 (1903).

But in *Axline v. Toledo, etc. R. Co.*, 138 Fed. 169 (1903), a directly contrary construction was placed upon a statute of Ohio similar to that of Missouri providing that "notwithstanding such lease the corporation of this State lessor therein, shall remain liable, as if it operated the road itself and both lessor and lessee shall be jointly liable on all rights of action accruing to any person for any negligence or default growing out of the operation and maintenance of such road or in any wise connected therewith."

The language of both the statutes in question is so broad that the Mis-

§ 217. **Lessor cannot avoid Primary Obligations unless exempted.** — Analogous to the rule that a railroad company after the lease of its road continues liable for any omission in the performance of duties imposed upon it by statute, is the rule that a lessor corporation, unless exempted, is responsible for any injury caused by a failure to fulfil its primary and positive obligations to the public. Thus, the duties of properly constructing and locating its railroad, bridges, and station houses, owed by the lessor corporation in the first instance,

Missouri decisions would seem the sounder in principle.

A *South Carolina* statute provides that a consolidated railroad company shall be subject to any action that may arise out of the operation of its lines of road, notwithstanding the lease of the same. Under this statute it is held that a railroad company which has leased its road is liable to an employee of the lessee for its negligence. *Reed v. Southern R. Co.*, 75 S. C. 162 (1906), (55 S. E. Rep. 218).

Under a statute providing that a lessor railroad company should remain liable for the acts of the lessee, it was held that the lessor was liable for permitting salt to remain on the tracks which attracted stock thereon, the stock being killed by a passing train. *Brown v. Hannibal, etc. R. Co.*, 27 Mo. App. 394 (1887).

In *California* by statute the lessor is liable for personal injuries due to improper construction of road. *Lee v. Southern Pacific R. Co.*, 116 Cal. 97 (1897), (47 Pac. Rep. 932, 38 L. R. A. 71, 58 Am. St. Rep. 140).

In *Mahoney v. Atlantic, etc. R. Co.*, 63 Me. 68 (1873), it was held that a provision that the lessor should not be exonerated by the lease from any existing liabilities left the lessor responsible for the torts, but not the contracts, of the lessee, and that a passenger assaulted by the lessee's servants upon its train had no right of action against the lessor because his demand was founded in contract.

This decision is not well founded in principle, for the passenger's right of action against the lessee for breach of its duty as a common carrier was clearly founded in tort.

Under the *Arkansas* statute (S. & H. Digest 1894, § 6349), providing that "all railroads which are now or may be hereafter built or operated in whole or in part in this State shall be responsible for all damages to persons and property done or caused by the running of trains in this State," one who has obtained a judgment against the lessee of a railroad can enforce payment by seizure and sale of the road itself. *Little Rock, etc. R. Co. v. Daniels*, 68 Ark. 171 (1900), (56 S. W. Rep. 874).

It will be observed that this statute makes the *railroad*, as distinguished from the railroad *corporation*, responsible for all damages resulting from its operation. For construction of this statute with respect to presumption of negligence, see *St. Louis, etc. R. Co. v. Evans*, 80 Ark. 19 (1906), (96 S. W. Rep. 616). Another *Arkansas* statute upon this subject appears in S. & H. Digest 1894, § 6334.

In *Ohio* (Bates' Anno. Stat. (1787-1902), § 3305), and *Texas* (Sayles' Civ. Stat. 1897 (Supp. to 1900), vol. ii. ch. 15a), it is provided that the lessor corporation shall remain liable as if it operated the road. See also *Missouri* statute in preceding note.

cannot be shifted to another corporation so as to absolve the lessor from liability unless immunity is expressly granted by statute.<sup>1</sup> As said by the Supreme Court of Maine in *Nugent v. Railroad Co.*:<sup>2</sup> "For an injury resulting from the negligent omission of some duty owed to the public, such as the proper construction of its road, station houses, etc., the charter company cannot, in the absence of statutory exemption, discharge itself of legal responsibility."<sup>3</sup>

This rule is based upon considerations of public policy which

<sup>1</sup> *United States*: In *Hayes v. Northern Pacific R. Co.*, 74 Fed. 282 (1896), Judge Jenkins said: "When there is due authority of law for the leasing of a railway, the company cannot, by leasing its line, discharge itself of those responsibilities which are imposed upon it by the law of its incorporation, and cannot relieve itself from liability in the discharge of those positive duties which it owes to the public, and have been specially imposed by its charter." See also *Arrowsmith v. Nashville, etc. R. Co.*, 57 Fed. 177 (1893).

*California*: *Lee v. Southern Pacific R. Co.*, 116 Cal. 97 (1897), (47 Pac. 932, 38 L. R. A. 71, 58 Am. St. Rep. 140).

*Kansas*: In *St. Louis, etc. R. Co. v. Curl*, 28 Kan. 622 (1882), (11 Am. & Eng. R. Cas. 458), Mr. Justice Brewer, then Judge of the Supreme Court of Kansas, said: "When the injury results from the omission of some duty, which the lessor itself owes to the public in the first instance, — something connected with the building of the road, — then we think the company assuming the franchise cannot divest itself of the responsibility by leasing its track to some other company." See also *Railway Co. v. Wood*, 24 Kan. 619 (1880).

*Maine*: *Nugent v. Railroad Co.*, 80 Me. 62 (1888), (12 Atl. Rep. 797, 6 Am. St. Rep. 151, 38 Am. & Eng. R. Cas. 52).

*Michigan*: A lessor is liable for an

additional servitude imposed upon land by a lessee. Thus, where a railroad company condemned a right of way for the passing of trains over private property and leased the same to a lessee who used it not only for that purpose but for switching purposes, thus causing additional damage to the adjoining property, it was held that the owner of such property was entitled to recover additional compensation from the lessor. *Backus v. Detroit, etc. R. Co.*, 71 Mich. 645 (1888), (40 N. W. Rep. 60).

*Pennsylvania*: *Kearney v. Cent. R. Co.*, 167 Pa. St. 362 (1895), (31 Atl. Rep. 637).

*Texas*: *Southern Kansas R. Co. v. Sage* (Tex. Civ. App., 1904), 80 S. W. Rep. 1038.

<sup>2</sup> *Nugent v. Railroad Co.*, 80 Me. 76 (1888), (12 Atl. Rep. 797, 38 Am. & Eng. R. Cas. 52, 6 Am. St. Rep. 151).

<sup>3</sup> But while a lessor railroad company is liable for defects in the original construction of the leased road, it is not (in a jurisdiction where the rule that a lessor under an authorized lease is not liable for the negligence of the lessee is followed) responsible for the subsequent failure of the lessee to keep the roadbed in repair.

*Ackerman v. Cincinnati, etc. R. Co.*, 143 Mich. 58 (1906), (106 N. W. Rep. 558, 114 Am. St. Rep. 640). Compare *Lee v. Southern Pac. R. Co.*, 116 Cal. 97 (1897), (47 Pac. Rep. 932, 38 L. R. A. 71, 58 Am. St. Rep. 140).

disregard the lease in fixing liability. Like the rule respecting statutory duties, it relates to the direct obligations of the lessor corporation. The lessor is held responsible under both rules for its own omissions.<sup>1</sup> It is chargeable with the neglect of the lessee only as such neglect constitutes its own default. Whether the lease is authorized or unauthorized is immaterial.

The result of the operation of either rule may, moreover, under certain conditions be obtained by the application of another and distinct principle. When the failure to fulfil a statutory obligation or perform a public duty results in a *nuisance*, the lessor, as well as the lessee, may be held responsible. The general principle of the law of landlord and tenant applies that both may be liable for a nuisance — the one for creating and the other for continuing it.<sup>2</sup> Thus, two railroad companies — lessor and lessee — have been held liable for an unlawful change of grade in the streets of a city, made before the lease and continued thereafter by the lessee;<sup>3</sup> and the same principle may be applicable where, notwithstanding statutes requiring fences, railroads are leased in an unfenced condition and are permitted to remain so.<sup>4</sup>

<sup>1</sup> *St. Louis, etc. R. Co. v. Curl*, 28 Kan. 622 (1882), (11 Am. & Eng. R. Cas. 458): "The injury resulted directly from its own wrong, and not from any mere negligence on the part of the [lessee] company. It cannot relieve itself by contracting with some other party to discharge its statutory duties."

<sup>2</sup> *Arrowsmith v. Nashville, etc. R. Co.*, 57 Fed. 165 (1893); *Swords v. Edgar*, 59 N. Y. 28 (1874), (17 Am. Rep. 295). Compare *Ditchett v. Spuyten Duyvil R. Co.*, 67 N. Y. 425 (1876), *Taylor's Landlord and Tenant*, § 175.

The lessor of a railroad is responsible for damages from an obstruction caused by a defect in a culvert or embankment built by it, and the lessee is not liable therefor unless it has been notified to remove the obstruction.

*Shores v. Southern R. Co.*, 72 S. C. 244 (1905), (51 S. E. Rep. 699).

<sup>3</sup> *Railroad Co. v. Hambleton*, 40 Ohio St. 496 (1884).

The lessor corporation, as well as the lessee, is liable for an injury done by the lessor in building its track so as to cut off ingress to adjoining property and by the lessee subsequently using the same. *Stickley v. Chesapeake, etc. R. Co.*, 93 Ky. 323 (1892), (20 S. W. Rep. 261).

A lessor of a railroad is not liable for damages to adjacent land caused by the erection of an embankment in filling in a trestle, it not appearing that the trestle was insufficient at the time of the lease. *Miller v. New York, etc. R. Co.*, 125 N. Y. 118 (1890), (26 N. E. Rep. 35).

<sup>4</sup> *Arrowsmith v. Nashville, etc. R. Co.*, 57 Fed. 165 (1893). In *St. Louis, etc. R. Co. v. Curl*, 28 Kan. 622 (1882), (11 Am. & Eng. R. Cas. 458), the question is raised but not decided.

§ 218. **Liability of Lessor for Negligent Operation of Railroad — (A) Under Unauthorized Lease.** — As a corollary to the conclusion that a railroad corporation cannot lease its railroad and franchises without statutory authority, it follows that a lease executed without such authority is void. A lessor corporation under an unauthorized lease continues liable for the negligence of the lessee affecting the public. With respect to the public, the lessee stands in the relation of an agent to the lessor.<sup>1</sup> The lessor is bound by its acts and is responsible for its omissions.<sup>2</sup>

<sup>1</sup> For consideration of liability of lessor to employees of lessee when lease is unauthorized, see *post*, § 220.

<sup>2</sup> I. *Cases holding lessor corporation — under unauthorized lease — liable for injuries to passengers:*

*United States:* Railroad Co. v. Brown, 17 Wall. 445 (1873).

*Georgia:* Central R., etc. Co. v. Phinazee, 93 Ga. 488 (1894), (21 S. E. Rep. 66).

*Iowa:* Bower v. Burlington, etc. R. Co., 42 Iowa, 546 (1876).

*Kentucky:* Brooker v. Maysville, etc. R. Co., 119 Ky. 137 (1904), (83 S. W. Rep. 117); Chesapeake, etc. R. Co. v. Osborne, 97 Ky. 112 (1895), (30 S. W. Rep. 21, 53 Am. St. Rep. 407).

*New York:* Abbott v. Johnstown, etc. R. Co., 80 N. Y. 27 (1880), (36 Am. Rep. 572).

*South Carolina:* Bouknight v. Charlotte, etc. R. Co., 41 S. C. 415 (1894), (19 S. E. Rep. 915).

*Texas:* International, etc. R. Co. v. Eckford, 71 Tex. 274 (1888), (8 S. W. Rep. 679).

*West Virginia:* Ricketts v. Chesapeake, etc. R. Co., 33 W. Va. 433 (1890), (10 S. E. Rep. 801, 25 Am. St. Rep. 901, 7 L. R. A. 354); Fisher v. West Virginia, etc. R. Co., 39 W. Va. 366 (1894), (19 S. E. Rep. 578, 23 L. R. A. 758).

II. *Cases holding lessor corporation — under unauthorized lease — liable for injuries to persons upon its tracks:*

*United States:* Briscoe v. Southern

Kansas R. Co., 40 Fed. 273 (1889) (live stock).

*Kentucky:* Louisville, etc. R. Co. v. Breeden's Admx., 111 Ky. 729 (1901), (64 S. W. Rep. 667).

*Minnesota:* Freeman v. Minneapolis, etc. R. Co., 28 Minn. 443 (1881), (10 N. W. Rep. 594, 7 Am. & Eng. R. Cas. 410).

*South Carolina:* Smalley v. Atlantic, etc. R. Co., 73 S. C. 572 (1906), (53 S. E. Rep. 1000).

*Texas:* Galveston, etc. R. Co. v. Gartiesier, 9 Tex. Civ. App. 456 (1895), (29 S. W. Rep. 939).

III. *Miscellaneous cases stating general rule that lessor is liable for negligence of lessee in operation of road under unauthorized lease:*

*United States:* Welden Nat. Bank v. Smith, 86 Fed. 398 (1898); Hayes v. Northern Pacific R. Co., 74 Fed. 282 (1896); Hukill v. Maysville, etc. R. Co., 72 Fed. 745 (1896); Arrow-smith v. Nashville, etc. R. Co., 57 Fed. 165 (1893); Van Dresser v. Oregon R., etc. Co., 48 Fed. 202 (1891).

*Alabama:* Rome, etc. R. Co. v. Chasteen, 88 Ala. 591 (1889), (7 So. Rep. 94).

*District of Columbia:* Howard v. Chesapeake, etc. R. Co., 11 App. Cas. 300 (1897).

*Idaho:* Palmer v. Utah, etc. R. Co., 2 Idaho, 350 (1888), (16 Pac. Rep. 553, 36 Am. & Eng. R. Cas. 443).

*Illinois:* Railway Co. v. Dunbar, 20 Ill. 623 (1858), (71 Am. Dec. 291).

“Shippers, who have a common-law right to demand of the common carrier that he shall carry their goods safely, passengers, who have a common-law right to demand of the common carrier that they shall be carried safely to their destination, and travellers upon the highway, who have a statutory and common-law right to such a reasonable and careful operation of the road as shall not unduly injure them in the pursuit of their lawful rights,” sustaining damages by the failure of a lessee, under an unauthorized railroad lease, to fulfil all the obligations required of railroad companies, may hold the lessor — as well as the lessee — responsible therefor.<sup>1</sup>

§ 219. **Liability of Lessor for Negligent Operation of Railroad — (B) Under Authorized Lease.** — Extending the principle, already considered, that the approval by the legislature of a railroad lease is insufficient without a clause of exemption to release a lessor from the performance of its statutory duties and the fulfilment of its primary obligations, it is held by courts of high authority that an express exemption is also necessary to relieve a lessor from liability for injuries to third persons caused by the negligence of a lessee in the operation and management of a leased railroad; that although the lessor has, with statutory authority, parted with the control of its railroad, it is still liable for the torts of the lessee.<sup>2</sup>

*Louisiana*: *Muntz v. Algiers*, etc. R. Co., 111 La. 423 (1903), (35 So. Rep. 624, 64 L. R. A. 222, 100 Am. St. Rep. 495).

*Oregon*: *Lakin v. Railroad Co.*, 13 Or. 436 (1886), (11 Pac. Rep. 68, 57 Am. Rep. 25).

*South Carolina*: *Harmon v. Columbia*, etc. R. Co., 28 S. C. 401 (1887), (5 S. E. Rep. 835, 13 Am. St. Rep. 686).

*Texas*: *Railroad Co. v. Culberson*, 72 Tex. 375 (1888), (10 S. W. Rep. 706, 13 Am. St. Rep. 805, 3 L. R. A. 567).

*Vermont*: *Nelson v. Railroad Co.*, 26 Vt. 717 (1854), (62 Am. Dec. 614).

<sup>1</sup> *Hukill v. Maysville*, etc. R. Co., 72 Fed. 752 (1896).

Where a railroad company, without authority, leases its railroad to another corporation, the lessee is considered its agent in the operation of the road, and in an action against the lessor for a tort committed by the lessee service of process upon the agents of the lessee has been held sufficient.

*Van Dresser v. Oregon R., etc. Co.*, 48 Fed. 202 (1891).

<sup>2</sup> *Connecticut*: In *Driscoll v. Norwich*, etc. R. Co., 65 Conn. 230 (1894), (32 Atl. Rep. 354), it was said that a railroad company cannot, by a lease of its property, absolve itself from liability for an injury to a stranger, caused by the negligence of the lessee in the operation of the road, unless such exemption is provided for in the

It is urged, in support of this position, that public policy requires that the obligations of a railroad corporation — to

lease, and is also expressly sanctioned by legislative authority.

The conclusion of the Court in this case can, however, be justified on other grounds. See *post*, § 221: "*Liability of Lessor for Negligent Operation of Railroad — (D) When it shares in Control.*"

*Georgia*: *Green v. Coast Line R. Co.*, 97 Ga. 27 (1895), (24 S. E. Rep. 814, 54 Am. St. Rep. 379, 33 L. R. A. 806): "It is by reason of this firm adhesion of duty imposed to franchise granted that an incorporated railroad company cannot lease its line of railway and permit it to be operated by the lessee without being liable for negligent torts committed by the lessee, to the same extent as if they were committed by itself. . . . And this rigid rule of liability, which is directly the opposite of that which prevails touching leases where no charter franchises of a quasi-public nature are involved, is not relaxed in favor of a company having express permission from the legislature to make the lease, unless there be also an express exemption or grant of absolute from liability. Thus, in the case of a mere permissive lease of a railroad, there is a cumulative rather than diminished security to the injured citizen, who for a tort committed . . . by the lessee, in the exercise of franchises derived from the lessor, can hold either or both answerable for the damages."

In *Singleton v. South Western R. Co.*, 70 Ga. 464 (1883), (48 Am. Rep. 574), a lessor was held liable for injuries to a passenger upon lessee's train through the negligence of lessee's servants. This decision was placed upon the broad ground that a lessor is liable for the torts of its lessee even under an authorized lease, but might well have been based upon the privity of

contract between the lessor and the passenger, for the *passenger's ticket was issued in the name of the lessor*. See also *Georgia R., etc. Co. v. Haas*, 127 Ga. 187 (1906), (56 S. E. Rep. 313); *Central R., etc. Co. v. Phinazee*, 93 Ga. 488 (1893), (21 S. E. Rep. 66); *Central R. Co. v. Brinson*, 64 Ga. 475 (1880).

*Illinois*: *Chicago, etc. R. Co. v. Schmitz*, 211 Ill. 446 (1904), (71 N. E. Rep. 1050); *Chicago, etc. R. Co. v. Doan*, 195 Ill. 168 (1902), (62 N. E. Rep. 826); *Balsley v. St. Louis, etc. R. Co.*, 119 Ill. 68 (1886), (8 N. E. Rep. 859, 59 Am. Dec. 784); *Pennsylvania Co. v. Ellet*, 132 Ill. 654 (1890), (24 N. E. Rep. 559, 42 Am. & Eng. R. Cas. 64); *Peoria, etc. R. Co. v. Lane*, 83 Ill. 448 (1876).

*Kentucky*: *McCabe's Admx. v. Maysville, etc. R. Co.*, 112 Ky. 876 (1902), (66 S. W. Rep. 1054): "By its acceptance of the franchises conferred by the State the corporation assumed the corresponding burdens thereby imposed. These franchises it could not transfer to another without distinct legislative authority. The grant of power to lease its property is one thing; the grant of absolute from responsibility is another, and is not to be inferred from a mere power to lease the road, where the corporation still retains its existence and the enjoyment of its franchises in the rents. For such grants are strictly construed, and, as against the public, are never extended by construction. In the case before us there is only a grant to the lessor of power to contract for the operating of the road. The company enjoys all its franchises in the fruits of the contract. There is nothing in the provision to show that the Legislature had in mind authorizing the company to divest itself of its franchises, or



persons using its road as passengers and shippers, to travelers upon highways crossed by its tracks — should not be dis-

permitting it, while enjoying them or their fruits, to be acquit of responsibility for their abuse, without regard to the financial ability of the lessee or his amenability to suit." *Compare*, however, *Harper v. Newport News, etc. R. Co.*, 90 Ky. 359 (1890), (14 S. W. Rep. 346).

*Massachusetts*: *Braslin v. Somerville Horse R. Co.*, 145 Mass. 68 (1887), (13 N. E. Rep. 65) (*per Allen, J.*): "It is nowhere stated that the lessor should be exonerated from responsibility, nor was it possible for the parties to make a contract which should have that effect. The sanction of the legislature was given the contract as made by the parties, but added nothing by way of exemption from the primary responsibility of the lessor. The lease did not purport to transfer the lessor's franchise, or the whole of its property. The lessor was not going out of business entirely, but only leased a portion of its road, with provisions for restoration of the leased property at the end of the term, and for reentry. It was under a positive duty and obligation to the public, and the consent of the legislature to the making of the lease did not imply a discharge from the duty and obligation. Indeed, there is a certain implication that the parties did not contemplate any such discharge, arising from the stipulation for indemnity "during said term," that is, during the whole term of the lease. Where a corporation seeks to escape from the burdens imposed upon it by the legislature, clear evidence of a legislative assent to such exoneration should be found."

In the earlier *Massachusetts* case of *Quested v. Newburyport Horse R. Co.*, 127 Mass. 204 (1879), a lessor was held liable to persons injured through the negligence of the lessee, but in that case it was expressly provided by

statute that the lease should not "release or exempt such company from any duties, liabilities or restrictions to which it would otherwise be subject."

*Mississippi*: *Illinois Central R. Co. v. Lucas*, 89 Miss. 411 (1907), (42 So. Rep. 607).

*Nebraska*: In *Chollette v. Omaha, etc. R. Co.*, 26 Neb. 159 (1889), (41 N. W. Rep. 1106, 4 L. R. A. 135), where a passenger was injured through the negligence of the lessee's employees, it was held that, upon grounds of public policy, the original obligation of a railroad company to the public cannot be discharged by a transfer of its franchises to another company, except by legislative enactment consenting to and authorizing such transfer, with an exemption granted to such company relieving it from liability; that mere legislative consent to the transfer is not sufficient, there must be a release from the obligations of the company to the public.

*North Carolina*: *Raleigh v. North Carolina R. Co.*, 129 N. C. 265 (1901), (40 S. E. Rep. 2); *Perry v. Western North Carolina R. Co.*, 129 N. C. 333 (1901), (40 S. E. Rep. 191); *Harden v. North Carolina R. Co.*, 129 N. C. 354 (1901), (40 S. E. Rep. 184, 85 Am. St. Rep. 747, 55 L. R. A. 784); *Pierce v. North Carolina R. Co.*, 124 N. C. 83 (1899), (32 S. E. Rep. 399, 44 L. R. A. 316); *Kinney v. North Carolina R. Co.*, 122 N. C. 961 (1898), (30 S. E. Rep. 313); *Logan v. North Carolina R. Co.*, 116 N. C. 940 (1895), (21 S. E. Rep. 959).

*South Carolina*: In *Harmon v. Columbia, etc. R. Co.*, 28 S. C. 401 (1888), (5 S. E. Rep. 835, 13 Am. St. Rep. 686), a lessor was held liable for stock killed through negligence of lessee. In *Parr v. Spartansburgh,*

charged by a lease of its property and franchises to another corporation unless it is exempted from liability by legislative authority; that when a corporation seeks to escape from the burdens imposed upon it, clear evidence of legislative assent to such exoneration must be shown, which is not furnished by a mere approval of the transfer of its property and franchises. As tersely expressed by the Supreme Court of Georgia in *Singleton v. South Western R. Co.*:<sup>1</sup> "The view which we take of the law and the cases cited is that the original obligations can only be discharged by legislative enactment consenting to and authorizing the lease, with an exemption to the lessor company."

On the other hand, it is said by courts of equally high authority that the legislature, by sanctioning a lease, gives its consent that the lessee shall stand as a substitute for the lessor with respect to all matters arising out of the future management and control of the leased railroad. It is held by these courts that a lessor having, with the approval of the legislature, leased and entirely parted with the possession and control of its railroad, is not liable for the torts of the lessee; that legislative exemption is not necessary in addition to legislative sanction.<sup>2</sup>

etc. R. Co., 43 S. C. 197 (1895), (20 S. E. Rep. 1009), (49 Am. St. Rep. 826), the Court went the extreme length of holding a lessor liable for the torts of a receiver of the lessee. This holding that a lessor is responsible for the management of property *in custodia legis* cannot be justified upon principle or authority. See also *Hart v. Railroad Co.*, 33 S. C. 427 (1890), (12 S. E. Rep. 9, 10 L. R. A. 794); *Chester Nat. Bank v. Atlanta, etc. R. Co.*, 25 S. C. 216 (1886).

*Tennessee*: In *Hanna v. Railway Co.*, 88 Tenn. 310 (1889), (12 S. W. Rep. 718, 6 L. R. A. 727), a railroad company was held not liable for an injury to an employee of a contractor, but the Court remarked that both "sanction and exemption" were necessary to relieve a lessor.

<sup>1</sup> *Singleton v. South Western R. Co.*, 70 Ga. 469 (1883), (48 Am. Rep. 574).

For consideration of proper pleading when it is sought to hold a lessor corporation liable for the acts or negligence of a lessee, see *Georgia R., etc. Co. v. Haas*, 127 Ga. 187 (1906), (56 S. E. Rep. 313).

<sup>2</sup> *United States v. Hayes v. Northern Pacific R. Co.*, 74 Fed. 282 (1896), (Jenkins, J.): "It is, however, a different question when the lessor company is sought to be made liable for the negligent management of the road which it was authorized to lease, and of which management it had no control. In such case, we perceive no ground of public policy which should impose such liability upon the lessor company with respect to injuries resulting to individuals

In *Arrowsmith v. Nashville, etc. R. Co.*,<sup>1</sup> Judge Lurton distinguished the case where statutory exemption is necessary

from the negligent operation of the railway. The subject has been much discussed, and some of the cases are characterized by lack of discrimination between liability for duties absolutely imposed by law upon the lessor company and duties arising from the manner of the operation of trains."

See also *Curtis v. Cleveland, etc. R. Co.*, 140 Fed. 777 (1905); *Yeates v. Illinois Central R. Co.*, 137 Fed. 943 (1905); *Arrowsmith v. Nashville, etc. R. Co.*, 57 Fed. 165 (1893), (a leading case).

*Arkansas*: *Little Rock, etc. R. Co. v. Daniels*, 68 Ark. 171 (1900), (56 S. W. Rep. 874).

*Kansas*: *St. Louis, etc. R. Co. v. Curl*, 28 Kan. 623 (1882): "If the injury results from negligence in the handling of trains or in the omission of any statutory duty connected with the management of the road, matters in respect to which the lessor company could, in the nature of things, have no control — then the lessee company will alone be responsible."

See also *Caruthers v. Kansas City, etc. R. Co.*, 59 Kan. 629 (1898), (54 Pac. Rep. 673, 44 L. R. A. 737).

*Maine*: *Nugent v. Railroad Co.*, 80 Me. 76 (1888), (12 Atl. Rep. 797, 6 Am. St. Rep. 151): "An authorized lease, without any exemption clause, absolves the lessor from the torts of the lessee resulting from the negligent operation and handling of its trains and the general management of the leased road, over which the lessor could have no control."

See also *Mahoney v. Atlantic, etc. R. Co.*, 63 Me. 68 (1873).

*Michigan*: *Ackerman v. Cincinnati, etc. R. Co.*, 143 Mich. 61 (1906), (106 N. W. 558): "No one doubts

that without statutory authority a railroad company would be precluded from substituting another in its place to perform its obligations to the State and public. This question was consistently disposed of in England, by the holding that a railroad company could not make a valid lease of its rights and franchises; this is upon the ground that the effect of a lease of property is to relieve the lessor from obligation to others in regard to its use, and that hence there could be no presumption of an intent to grant the power to lease — a logical conclusion. But the doctrine that a statutory authority to lease a railroad leaves the lessor liable to the full extent that it would be if it operated the road itself, unless it be expressly stated to the contrary in the statute, can rest on nothing less than a supposed legislative intent to use the word 'lease' in a limited and different sense than that usually given the term."

*Minnesota*: *Heron v. St. Paul, etc. R. Co.*, 68 Minn. 542 (1897), (71 N. W. Rep. 706).

*Missouri*: *Moorshead v. United Rys. Co.*, 119 Mo. App. 541 (1906), (96 S. W. Rep. 261), *affirmed* 203 Mo. 121 (1907), (100 S. W. Rep. 611): "The reasoning of these cases is, in the main, that when the legislature by statute confers the authority on a railroad company to lease its properties, and on another company to take and operate them, and, pursuant to such statute, a lease is made turning over all property in an unrestricted way to the lessee, the proper view is that the legislature intended that all the ordinary incidents of a lease should accompany the transaction and the lessor not remain liable for operating torts."

<sup>1</sup> *Arrowsmith v. Nashville, etc. R. Co.*, 57 Fed. 177 (1893).

from that where statutory sanction is sufficient: "Where obligations are imposed by charter or statute law upon a railroad company for the protection and advantage of the general public not having contract relations with it, it may very well be said that a general authority to lease out its road, which contains no provision exempting it from such public obligations, will not absolve it from liability. So, if a railway be in such condition that it is a nuisance when leased out by reason of the absence of something necessary to its safe operation, or the presence of something dangerous to its safe operation, and this nuisance be continued by the lessee, both the lessor and lessee would be liable, — the one as having created, and the other as having continued the nuisance. But to say that, after the lessor has, by authority of law, transferred the control and management of its road to another, he shall, unless especially exempted, remain liable for all the torts and contracts of the lessee, is to ignore the contract of lease and the legislative sanction under which it was made. The State, on grounds of public policy, may well refuse its consent to the transfer; but if it consent, then there is no public policy to authorize the courts to say that the responsibility for the future management and operation of the road has not been exclusively

This was a case of a street railway lease. A steam railroad company as lessor is liable for the negligence of its lessee under a Missouri statute. See notes to § 216, *ante*: "*Lessor Corporation cannot avoid Statutory Obligations unless exempted.*"

*New Hampshire*: *Murch v. Concord R. Co.*, 29 N. H. 1 (1854).

*New York*: *Phillips v. Northern R. Co.*, 41 N. Y. St. Rep. 780 (1891), (16 N. Y. Supp. 909). In *Ditchett v. Spuyten, etc. R. Co.*, 67 N. Y. 425 (1876), it was held that a railroad corporation which had parted with the possession and control of its road under a lease thereof to another corporation, containing a covenant that the lessees should keep up the fences was not liable to one travelling

upon a highway, for damages resulting from an omission of the lessee to repair a fence which was in good order at the time of the lease and surrender of possession.

See also *Miller v. Railroad Co.*, 125 N. Y. 118 (1890), (26 N. E. Rep. 35); *Fisher v. Metropolitan El. R. Co.*, 34 Hun (N. Y.), 433 (1885).

*Pennsylvania*: *Pinkerton v. Philadelphia Traction Co.*, 193 Pa. St. 229 (1899), (44 Atl. Rep. 284).

*Texas*: *Houston, etc. R. Co. v. McFadden*, 91 Tex. 194 (1897), (40 S. W. Rep. 216, 42 S. W. Rep. 593); *Missouri Pacific R. Co. v. Watts*, 63 Tex. 549 (1885).

*Virginia*. *Virginia, etc. R. Co. v. Washington*, 86 Va. 629 (1890), (10 S. E. Rep. 927).

imposed upon the lessee as the lawful substitute for the company owning the road."

Upon principle there is no obvious reason why, when the legislature has authorized a railroad company to lease its railroad, and it has exercised the power conferred and has entirely parted with the control of the leased property, it should still be responsible for the negligence of the lessee in the operation of the road. The doctrine of *respondeat superior* has no application, for the lessee is the owner *pro hac vice*. The legislature has passed upon considerations of public policy in authorizing the lease. Under these conditions, it would seem that the privileges and corresponding obligations should both pass to the lessee in the manner of other property, and that the general principle that a landlord is not responsible for the negligence of his tenant in the management of the leased property should be applicable and controlling.

The federal courts in adopting the view just stated, that the lessor corporation under an authorized lease is not responsible for the negligence of the lessee, so hold as a matter of general law, and are not controlled by the decisions of the courts of the State in which the railroad is located.<sup>1</sup>

<sup>1</sup> *Yeates v. Illinois Central R. Co.*, 137 Fed. 943 (1905).

In *Curtis v. Cleveland, etc. R. Co.*, 140 Fed. 578 (1905) the Court said: "The question for decision, therefore, is whether the mere leasing of the right of way, track, turnouts, and stations to be used and operated exclusively by another *ipso facto* reserves or creates a liability against the lessor for the negligence of the lessee in its own exclusive use of operating appliances owned and controlled by it upon the track and right of way possessed and used under the terms of the lease. The Supreme Court of Illinois has decided (*Chicago, etc. R. Co. v. Hart*, 209 Ill. 414 (1904), (70 N. E. 654, 66 L. R. A. 75)) that both lessor and lessee companies are liable for such negligence, and that a joint action may be maintained against them for damages. The

weight of federal decisions establishes the contrary rule. . . . The rule of law in question is not local, or the effect of a statute, or its construction, but exists as a general rule of the common law, which the federal courts determine for themselves. One of the benefits secured through federal jurisdiction is the uniform and equal administration of the law affecting the rights of citizens of different States, and, if we were required to follow the decision of the local courts upon questions not arising upon the statutes of the State, with great respect to the State courts, be it said, there would be more or less discord and uncertainty in the decisions. It would be an anomaly, were this court required to hold the law different from its own judgment of what it is, except in obedience to superior authority, in order that the

§ 220. **Liability of Lessor for Negligent Operation of Railroad — (C) To Employees of Lessee.** — The rule that a lessor corporation, under an unauthorized lease, is responsible to the public for the negligence of the lessee is, upon principles already illustrated, well settled.<sup>1</sup> A similar rule, in favor of the employees of the lessee, has been adopted by several courts upon the theory that the original obligation of the lessor to compensate its own servants for injuries received enures to the benefit of the servants of the lessee.<sup>2</sup> And, extending this theory upon what are denominated grounds of public policy, two courts, at least, hold that a lessor corporation even under an *authorized* lease is responsible for injuries to the lessee's employees due to its negligence.<sup>3</sup>

jurisdiction of the State court may be sustained and its own jurisdiction defeated."

<sup>1</sup> *Ante*, § 218: "*Liability of Lessor for Negligent Operation of Railroad — (A) Under Unauthorized Lease.*"

<sup>2</sup> In *Logan v. North Carolina R. Co.*, 116 N. C. 949 (1895), (21 S. E. Rep. 959), the Court said: "If we apply the test which we hold to be the true one, that the liability of the lessor grows out of the duty imposed with the privilege in the first instance, the same reason is found to exist for holding it liable to servants of the lessee for injuries sustained by them, as for injuries inflicted on passengers. A part of the original duty imposed by the charter was to compensate servants in damages for any injuries they might sustain, except such as should be due to the negligence of their fellow-servants. The employee is deemed in law to contract ordinarily to incur such risks as arise from the carelessness of the other servants of the company, but where the lessor company would be liable, if it remained in charge of the road, to a person acting as its own servant, we see no reason why it should not be answerable to him when employed by the lessee. Its *implied* obligation in

the first instance — to come back to the touchstone — was to compensate its own servants for injuries due to any cause other than the carelessness of their fellows, and the same rule must apply in its relation with the servants of the lessee."

In *Macon, etc. R. Co. v. Mayes*, 49 Ga. 355 (1873), (15 Am. Rep. 678), the Court held, generally, that a lessor, under an unauthorized lease, is liable to an employee of the lessee for injuries caused by the negligent operation of the road, but in that case the negligence was actually that of the *lessor* itself. Compare *Galveston, etc. R. Co. v. Daniels*, 9 Tex. Civ. App. 253 (1894), (28 S. W. Rep. 548).

<sup>3</sup> In *Chicago, etc. R. Co. v. Hart*, 209 Ill. 414, 421 (1904), (70 N. E. Rep. 654, 66 L. R. A. 75), the Supreme Court of Illinois said: "In the absence of statutory exemption from liability for the negligence of the lessee company, the obligation to respond for such negligence is also to be maintained upon grounds of public policy. The fact that the contract relation is between the employee and the lessee company, and was voluntarily entered into by the employee with the lessee company alone cannot be allowed to control. . . .

These doctrines are believed to be fundamentally unsound. The obligations of the lessor to its own servants grow out of the contract of employment. Their duties are reciprocal. But after the lease of a railroad there is no privity of contract between the lessor and the servants of the lessee. An employee of the lessee owes the lessor no duty, and the lessor owes him no corresponding obligation. Upon principle and the weight of authority, the lessor corporation is not liable to an employee of the lessee for injuries sustained through the negligence of the lessee in the operation of the road, even though the lease be without legislative sanction. "To his own master he standeth or falleth."<sup>1</sup> *A fortiori* is this true where the legis-

The obligation to provide cars and engines that are reasonably safe and servants that are reasonably competent and skilful, which was cast upon the lessor company by the grant to it of its corporate powers, is not shifted to one with whom it has contracted to operate its road as lessee, but remains to be discharged by the lessor company to all the public, and to relieve it of that duty as to its employees would be to invite negligence from which injury to the public would likely occur. The lessee's employees are a part of the general public and the lessor company is liable to them for the actionable negligence of the lessee company to the same extent as if such workmen were in the employ of the lessor company."

See also *Harden v. North Carolina R. Co.*, 129 N. C. 354 (1901), (40 S. E. Rep. 184, 55 L. R. A. 784, 85 Am. St. Rep. 747).

*Reed v. Southern R. Co.*, 75 S. C. 162 (1906), (55 S. E. Rep. 218) states similar general views, but the decision is based primarily upon the South Carolina statute referred to in note to § 216, *ante*: "*Lessor Corporation cannot avoid Statutory Obligations unless exempted.*"

<sup>1</sup> In *East Line, etc. R. Co. v. Culbertson*, 72 Tex. 379 (1888), (10 S. W.

Rep. 706, 13 Am. St. Rep. 805, 3 L. R. A. 567, 38 Am. & Eng. R. Cas. 225), where a conductor upon a train of a lessee corporation, under an unauthorized lease, was injured by the negligence of the lessee in supplying a defective engine and employing a careless engineer, the Court said: "The duties which are owed by a railroad company to its servants are not duties owed to him in common with the public, but grow out of the contract of service. He assumes the relation of servant to his employer voluntarily, and out of it arises the reciprocal obligations from one to the other. It seems to us that the relation of the servant of the company operating the road to the owner is very different from his relation to his employer, and that the relation of the owner of the road to him is different from its relation to the general public. His contract is not with the company owning the road, and, it may be asked, does the latter owe him the duty of a master to a servant, or guarantee that the master with whom he has voluntarily contracted will perform its obligation to him? It may be that if the injury had occurred by reason of a defect in the roadbed or track and not by reason of a defect in the engine, the company charged with the duty

lature has authorized the lease. In such a case there is not only no privity between the parties but the legislature in sanctioning the lease has itself determined the questions of public policy involved.<sup>1</sup>

The rules already considered, however, that a lessor corporation is liable for any failure in the performance of its own statutory and primary duties, unless expressly exempted,<sup>2</sup> are applicable in favor of employees of the lessee, as well as other persons. Thus, a lessor may be liable to such employees for injuries caused by the improper construction of a station-house<sup>3</sup> and by defects in the roadbed where the owner is charged with the duty of keeping it up.<sup>4</sup>

of keeping up the road would be liable. But if it were true that the injury was caused entirely by another company operating the owner's road, and was inflicted upon one of its own employees by reason of a defect in machinery entirely under its control, it is difficult to see upon what principle of policy or justice the lessor should be held liable merely because it owned the road."

See also:

*United States*: *Hukill v. Maysville*, etc. R. Co., 72 Fed. 745 (1896); *Hayes v. Northern Pacific R. Co.*, 74 Fed. 279 (1896); *Williard v. Spartansburg*, etc. R. Co., 124 Fed. 796 (1903).

*Indiana*: *Baltimore*, etc. R. Co. v. Paul, 143 Ind. 23 (1895), (40 N. E. Rep. 519, 28 L. R. A. 216).

*Mississippi*: *Buckner v. Richmond*, etc. R. Co., 72 Miss. 873 (18 So. Rep. 449).

*Tennessee*: *Hanna v. Railway Co.*, 88 Tenn. 310 (1889), (12 S. W. Rep. 718, 6 L. R. A. 727).

*Texas*: *Baxter v. New York*, etc. Co., 22 S. W. Rep. 1002 (1893).

*Virginia*: *Virginia Midland R.*

*Co. v. Washington*, 86 Va. 629 (1890), (10 S. E. Rep. 927).

<sup>1</sup> See cases cited in preceding note and also: *Lee v. Southern Pacific R. Co.*, 116 Cal. 97 (1897), (47 Pac. 932, 38 L. R. A. 71, 58 Am. St. Rep. 140); *Swice v. Maysville*, etc. R. Co. 116 Ky. 253 (1903), (75 S. W. Rep. 278); *Missouri Pacific R. Co. v. Watts*, 63 Tex. 549 (1885).

In *Banks v. Georgia R. etc. Co.*, 112 Ga. 655 (1900), (37 S. E. Rep. 992) a lessor company which had leased its railroad with legislative authority was held not liable for an injury to a lessee's employee caused by the negligence of a co-employee. In this case the Court distinguished *Macon*, etc. R. Co. v. *Mayes*, 49 Ga. 355 (1873), cited in a preceding note, upon the ground that there was in that case no legislative authority for the lease.

<sup>2</sup> See *ante*, § 216: "Lessor cannot avoid Statutory Obligations unless exempted"; *ante*, § 217: "Lessor cannot avoid Primary Obligations unless exempted."

<sup>3</sup> *Nugent v. Boston*, etc. R. Co., 86

<sup>4</sup> *East Line*, etc. R. Co. v. *Culbertson*, 72 Tex. 375 (1888), (10 S. W. Rep. 706, 13 Am. St. Rep. 805, 3 L. R. A. 567, 38 Am. & Eng. R. Cas. 225); *Galveston*, etc. R. Co.

v. *Daniels*, 9 Tex. Civ. App. 253 (1894), (28 S. W. Rep. 548). See, however, *Murch v. Concord R. Corp.*, 29 N. H. 9 (1854), (61 Am. Dec. 631).



§ 221. **Liability of Lessor for Negligent Operation of Railroad** — (D) **When it shares in Control.** — A cogent reason why a railroad corporation which has, with legislative sanction, leased and turned over the possession of its road to another company should not be held responsible for the torts of the lessee is that they are committed by persons over whom it has no control, upon property in the exclusive possession of another. This reason fails when the lessor, having leased its railroad, retains any part in its control. Thus, for example, where a lease provided that the managing agent of the leased road should be satisfactory to the lessor, and that its treasurer should receive and disburse the earnings,<sup>1</sup> it was held that the lessor, as well as the lessee, was responsible for all injuries to the public through the negligent operation of the road. Where the control retained amounts to joint management, the lessor is undoubtedly liable for injuries to employees equally with the lessee.

Upon other principles — contractual liability and estoppel — the lessor corporation will be held responsible where it allows the lessee to use its name in the operation of the leased road and in the issue of tickets for travel thereon.<sup>2</sup>

Me. 62 (1898), (12 Atl. Rep. 797, 6 Am. St. Rep. 151). The lessor has, however, been held not liable for injuries received by an employee of the lessee when the proximate cause of the injury was the running of the train by a co-employee, although a defective railroad platform contributed to the injury. *Evans v. Sabine, etc. R. Co.* (Tex. 1892), (18 S. W. Rep. 493). See also *Jones v. Georgia Southern R. Co.*, 66 Ga. 558 (1881).

<sup>1</sup> In *Driscoll v. Norwich, etc. R. Co.*, 65 Conn. 230 (1894), (32 Atl. Rep. 354), the Court held a lessor corporation responsible for the negligence of its lessee upon several grounds, and, while some of them seem opposed to the current of authority, the following ground, as stated by Chief Justice Andrews (p. 254), is unexceptionable: "The defendant pre-

serves to itself an absolute control over all business done by the lessee upon the leased property, by requiring that the managing agent to be appointed by the lessee shall be a person satisfactory to itself; that its own treasurer shall collect all the money received from and the earnings of the leased property, and have possession of the same; from which he shall pay all the expenditures and dues incurred in respect to the property demised, all taxes, assessments, and other liabilities, and shall, at the end of each six months, pay to himself for and on account of the defendant, the semi-annual rent due by the terms of the contract, and the balance, if any, deliver over to the lessee, the said New York and New England Railroad Company."

<sup>2</sup> *Bower v. Burlington, etc. R. Co.*,

In *Railroad Co. v. Brown*<sup>1</sup> the Supreme Court of the United States said: "The holder of such a ticket contracts for carriage with the company, not with the lessees and receiver. Indeed, there is nothing to show that Catherine Brown knew of the difficulties into which the original company had fallen, nor of the part performed by the lessees and receiver in operating the road. She was not required to look beyond the ticket, which conveyed the information that this road was run, as railroads generally are, by the chartered company. Besides, the company, having permitted the lessees and receiver to conduct the business of the road in this particular as if there were no change of possession, is not in a position to raise any question as to its liability for their acts."

§ 222. **Liability of Lessor upon Contracts of Lessee.** — Where a railroad company leases its railroad to another corporation, with or without legislative authority, it is not liable upon contracts made by the lessee with third persons, not relating to the performance of its duties to the public.<sup>2</sup> There is no privity between the lessor and the parties to such contracts, nor are there reasons of public policy which require that the lessee should be considered the agent of the lessor in their execution.

Contracts of the lessee relating to the discharge of the lessor's public duties stand upon a different basis. In case of an unauthorized lease, the lessee, in the operation of the road, is treated as the agent<sup>3</sup> of the lessor, and the lessor may be held

42 Iowa, 546 (1876); *Singleton v. Southwestern R. Co.*, 70 Ga. 464 (1883), (48 Am. Rep. 574); *Harmon v. Columbia, etc. R. Co.*, 28 S. C. 401 (1887), (5 S. E. Rep. 835, 13 Am. St. Rep. 686).

<sup>1</sup> *Railroad Co. v. Brown*, 17 Wall. (U. S.) 451 (1873).

<sup>2</sup> *Pittsburgh, etc. R. Co. v. Harbaugh*, 4 Brewst. (Pa.) 115 (1870). Compare *International, etc. R. Co. v. Thornton*, 3 Tex. Civ. App. 197 (1893), (22 S. W. Rep. 67).

A lessor is not liable for construction work done by contractors having contracts solely with the lessee. *St. Louis, etc. R. Co. v. Ritz*, 30 Kan. 30 (1883), (1 Pac. Rep. 27).

<sup>3</sup> In *Nelson v. Vermont, etc. R. Co.*, 26 Vt. 721 (1854), (62 Am. Dec. 614), Judge Redfield used this comprehensive language: "The lessors must, at all events, be held responsible for just what they expected the lessees to do, and probably, for all which they do do, as their general agents. For the public can only look to that corporation to whom they have delegated this portion of the public service."

It is incorrect to say, however, that the lessee is the *general agent* of the lessor, except so far as relates to the performance of its public duties.

responsible, in actions *ex contractu* upon contracts of carriage and in actions *ex delicto* for any failure to perform the obligations imposed by law upon common carriers.<sup>1</sup> The foundation of liability in each case is the same. The lessee is agent of the lessor because the public have the right to look to the corporation to which they have delegated the performance of public duties. The lessor is responsible for the negligence of the lessee because it cannot, by its own action, absolve itself from its obligations to the public.<sup>2</sup>

The foundation of the lessor's liability in actions *ex contractu* being the same as that in actions *ex delicto*, the liability of a lessor, under an authorized lease, upon the contracts of the lessee is determinable according to the principles already considered which fix its liability for negligence. In the jurisdictions which require an express legislative exemption to relieve a lessor in the case of negligence, it is undoubtedly necessary in the case of a contract. If legislative sanction is sufficient in the one case, it is sufficient in the other.<sup>3</sup>

§ 223. **Liability of Lessor for Reconstruction and Repairs.** — At common law, in the absence of an express covenant in the lease, the lessor was not bound to repair or rebuild, or to allow the lessee compensation for repairs made without his authority. The lessee took the leased property as he found it, and there was no implied covenant or warranty on the part of the lessor in regard to the condition of the property, its continuance in its existing condition through the term, or its availability for the purposes for which it was leased.

These principles, except as they have been modified by

<sup>1</sup> *Chester National Bank v. Atlanta, etc. R. Co.*, 25 S. C. 216 (1886).

Lessor is liable for lessee's failure to carry goods. *Central, etc. R. Co. v. Morris*, 68 Tex. 49 (1887), (3 S. W. Rep. 457). Lessor is liable for goods received by it to be carried by its lessee, a foreign corporation. *Langley v. Boston, etc. R. Co.*, 10 Gray (Mass.), 103 (1857).

<sup>2</sup> The foundation of liability in actions *ex delicto* and actions *ex contractu* is that the company, by accept-

ing its charter, has assumed obligations from which it cannot absolve itself by leasing its road to another company; and as such company is not only under obligations to carry passengers safely but also to deliver goods intrusted to it for transportation, the same principles apply in each case. *Chester National Bank v. Atlantic, etc. R. Co.*, 25 S. C. 216 (1886).

<sup>3</sup> See *ante*, § 219: "Liability of Lessor for Negligent Operation of Railroad — (B) Under Authorized Lease."

statute, are still of general application and apply where the property leased is a railroad. A railroad company, leasing its railroad, remains under no obligation, unless it is so provided in the lease, to rebuild bridges or other similar property, whether regarded as repairs, reconstruction or substitution, or to reimburse the lessee corporation or its receiver for any such improvements made upon the leased road without its authority.<sup>1</sup>

§ 224. **Taxation of Leased Railroads.** — The exercise of the taxing power is evidenced entirely by statutes which, in the different States, vary widely in their provisions.

Especially is this true in the matter of the taxation of railroad companies. The method of assessment, whether upon earnings, capital stock or property, and the manner of collection, are governed by statutes of essentially different character in different States. The respective obligations of lessor and lessee corporations to pay taxes, the question whether leasehold interests are taxable separately from the fee, and the obligations of foreign lessor corporations regarding taxes, may also properly be determined by statutory provisions.<sup>2</sup>

<sup>1</sup> *Felton, Receiver, v. City of Cincinnati*, 95 Fed. 336 (1899). In this case a receiver was appointed, at the suit of creditors and stockholders, for the property of a railroad company whose only interest in the road it operated was a leasehold for a term of years. The lessor was not a party to the suit. It was held that the principles upon which courts authorize expenditures by receivers of railroads in foreclosure suits for necessary improvements, and charge the cost as a first lien on the property, do not authorize a court to charge the cost of bridges rebuilt by a receiver under order of the court upon the lessor's interest in the property, where the lease gives the lessee no right to make such improvements at the lessor's expense.

A lease of a railroad provided that when the parties agreed that new equipment was needed the same

should be furnished by the lessor. The purchasing agent of the lessee ordered equipment and directed that it should be charged to the lessor, but there was no agreement to that effect and no demand made upon the lessor to furnish such equipment. It was held that the lessee, and not the lessor, was liable.

*Southern R. Co. v. Ensign Mfg. Co.*, 117 Fed. 417 (1902).

<sup>2</sup> *Arkansas*. San. & H. Dig. 1894, § 6333: If a railroad company of another State leases a railroad in this State such part of the railroad as is within this State is subject to taxation.

*Kansas*. G. S. 1897, ch. 70, § 96: Nothing in the provisions authorizing leases of railroads to foreign corporations shall be construed as curtailing any rights of the State, or counties, etc. of this State, through which road is located, to levy and collect taxes

As a general rule in America, real estate is taxable as a whole, without regard to separate estates of different persons therein,<sup>1</sup> and is assessed in the name of the *lessor* — as owner — rather than in the name of the *lessee*.<sup>2</sup> These principles

on the same, in conformity with the provisions of the laws of this State.

*Missouri.* R. S. 1899, § 1060: Similar to Arkansas provision, *supra*.

*Montana.* Code 1895, § 923: Similar to Kansas provision, *supra*.

*Nebraska.* Comp. Stat. 1901, § 1768: Lessees of railroads "shall cause the same to be listed for taxation." *Ib.* § 4026: Similar to Kansas provision, *supra*.

*North Carolina.* Pub. Laws 1895, ch. 116, § 40, p. 127: Where a railroad is operated in this State by virtue of a lease, taxes shall be paid by the lessee and may be charged against, and deducted from, any payments due or to become due the lessor on account of the lessee or otherwise.

*Ib.* § 48, p. 151: If the property of any railroad company be leased or operated by any other corporation, foreign or domestic, the property of the lessor shall be subject to taxation.

*South Dakota.* Anno. St. 1901, § 3906: Nothing in the provisions of the statute authorizing leases shall curtail the right of the State and counties through which the road is located, to levy and collect taxes; and all roads leased or purchased shall be subject to taxation.

*Wyoming.* R. S. 1899, § 3206: Similar to South Dakota provision, *supra*.

<sup>1</sup> Cooley on Taxation, p. 288.

<sup>2</sup> In *Rutland R. Co. v. Central Vermont R. Co.*, 63 Vt. 25 (1890), (21 Atl. Rep. 262, 10 L. R. A. 562), the Supreme Court of Vermont said regarding a tax on earnings: "Under the original as well as the modified lease no provision for the payment of taxes was made. The lease being

silent, the duty to pay, under the common law, rested upon the lessor."

In this case [*Rutland R. Co. v. Central Vermont R. Co.*], it was also held that a statute levying a tax on the gross receipts of railroad companies and providing that in the case of a leased road the tax should be paid by the lessee corporation and deducted from the rent was not unconstitutional as impairing the obligation of the contract of lease. The Court said: "It is further contended that our law violates another clause of the federal constitution in that it impairs the obligation of the contract subsisting between the parties respecting the payment of rent, by requiring the lessee to pay the tax and deduct the same from the stipulated rent. . . . We think the method prescribed for the collection of the tax is no impairment of the contract to pay the rent due under the lease. . . . When, therefore, the parties made the lease . . . both parties made their contract with notice of, and in subordination to the right of the State to exact from the fruits of their contract by way of taxation such sum as it might properly collect for public purposes. Having then the right to levy the tax the method to be adopted for its collection is purely a question of legislative discretion with which the court has no power to interfere so long as no legal or constitutional rights are disturbed. . . . We hold, therefore, that the section . . . is not unconstitutional in respect to the method prescribed for the collection of taxes assessed upon the earnings of railroads operated by lessees."

See also *Irvin v. New Orleans*, etc.

are applicable to railroads, in the absence of controlling statute, and must be followed irrespective of covenants in the lease, which merely determine the obligations of the parties between themselves.<sup>1</sup>

An exception to the general rule that, in the absence of a governing statute, taxes are assessed in the name of the lessor, has sometimes been made in the case of leases in perpetuity, and might properly be made in the case of other long term railroad leases. These exceptions, however, in no way modify the principle, for a lessee under such a lease is treated for purposes of taxation as the *owner*, and the lease as equivalent to a conveyance in fee in consideration of an annuity.<sup>2</sup>

R. Co., 94 Ill. 105 (1879), (34 Am. Rep. 208); Wood's Landlord and Tenant, p. 685; Taylor's Landlord and Tenant, pp. 341, 395.

In *Maryland* the general principle that the lessor is bound to pay all State and municipal taxes is modified by statutes requiring the lessee to pay them but giving him, in the absence of other agreement, the right to recover the amount paid from the lessor or to deduct it from the rent. *Philadelphia, etc. R. Co. v. Appeal Tax Court*, 50 Md. 397 (1879).

Upon the principle that only the owners of railroads are liable for assessments, it has been held that the lessee of a railroad cannot be held liable for a ditch assessment. *Baltimore, etc. R. Co. v. Pausch*, 7 Ohio N. P. 624 (1896).

Under a New Mexico statute providing that leased property shall be taxed to the lessor unless listed by the lessee, railroad property, held under lease, cannot be assessed against the lessee unless so listed. *Valencia County v. Atchison, etc. R. Co.*, 3 N. M. 677 (1886), (10 Pac. Rep. 294).

<sup>1</sup> *Ante*, § 205: "Covenant to pay Taxes."

<sup>2</sup> Where the charter of a railroad

company authorized it to acquire, by lease or purchase, any necessary extension of its road, and provided that all property so acquired should become part of its property, and in pursuance thereof it leased other railroads forever, and provided in the leases that the roads so leased should become and be operated as a part of its main line, it was held that the leased railroads would, if not for all purposes, at least for the purposes of taxation, be regarded as the property of the lessee. *Huck v. Chicago, etc. R. Co.*, 86 Ill. 352 (1877). See also *Appeal Tax Court v. Western Maryland R. Co.*, 50 Md. 274 (1879); *Commonwealth v. Nashville, etc. R. Co.*, 93 Ky. 430 (1892), (20 S. W. Rep. 383). Compare *State v. Housatonic R. Co.*, 48 Conn. 44 (1880).

In *People v. Feitner*, 171 N. Y. 641 (1902), (63 N. E. Rep. 786), however, it was held where one railroad company leased the railroad of another company for the entire life of the latter's charter and the renewals thereof, that the lessee acquired only a lessee's interest, with a right to use the leased property upon payment of the rental, and was not taxable as owner.

## CHAPTER XX

## RIGHTS AND LIABILITIES OF LESSEE CORPORATION

I. *Rights and Remedies of Lessee Corporation*

- § 225. Rights of Lessee in General. Incidental Franchises.
- § 226. Rights of Lessee in Matter of Tolls.
- § 227. Mortgages of Leases.
- § 228. Remedies of Lessee Corporation.

II. *Liabilities of Lessee Corporation*

- § 229. Obligation of Lessee to perform Lessor's Public Duties.
- § 230. Statutory Liability of Lessee.
- § 231. Liability of Lessee for Torts in Operation of Road under Authorized or Unauthorized Lease.
- § 232. Joint Liability of Lessor and Lessee.
- § 233. Liability of Lessee for Debts of Lessor.

I. *Rights and Remedies of Lessee Corporation*

§ 225. **Rights of Lessee in General. Incidental Franchises.** — Under a lease of a railroad and franchises, by legislative authority, the lessee as a general rule succeeds to all the rights and privileges of the lessor and is entitled to the full enjoyment of the property leased.<sup>1</sup> But the lessee acquires by the lease no rights superior to those enjoyed by the lessor. The power to lease does not imply power to transfer greater privileges than the lessor possesses.<sup>2</sup> A lessee takes the benefit of

<sup>1</sup> *Fisher v. New York, etc. R. Co.*, 46 N. Y. 644 (1871); *Chicago v. Evans*, 24 Ill. 52 (1860).

A statute authorizing a foreign railroad company to lease a domestic railroad invests the foreign corporation with all the powers and franchises of the lessor corporation with respect to the leased road.

*Canton v. Canton, etc. Co.*, 84 Miss. 268 (1904), (36 So. Rep. 266, 65 L. R. A. 561, 105 Am. St. Rep. 528).

The servants of a lessee corporation are not servants of the lessor for the service of process.

*Chicago, etc. R. Co. v. Weber*, 219 Ill. 373 (1905), (76 N. E. Rep. 489, 4 L. R. A. (n. s.) 272).

The contrary is, however, held under an *unauthorized* lease in *Van Dresser v. Oregon R., etc. R. Co.*, 48 Fed. 202 (1891).

In *Pennsylvania* (Bright. Pur. Dig. 1894, § 123, p. 1804) the lessee corporation may indorse, guarantee or otherwise become liable for, or assume the principal and interest of, bonds of the lessor corporation.

<sup>2</sup> *Nibbs v. Chicago, etc. R. Co.*, 39 Iowa, 344 (1874): "It (the lessee) can exercise no right which its lessor could

contracts for the use of railroad property, entered into by the lessor with other corporations,<sup>1</sup> and may purchase the leasehold interests of the lessor in connecting lines.<sup>2</sup> And where a portion of the leased property is taken by process of condemnation for the use of another corporation, the lessee is entitled to the use of the money awarded as compensation during the remainder of the term of the lease.<sup>3</sup>

A lessee taking under a lease a railroad, without other words of description in the lease or governing statute, takes, as incidental thereto, such rights and franchises as are necessary for the continued operation of the road.<sup>4</sup> Only such rights and franchises, however, as are *essential* to such purpose are so acquired and, as already shown, the lessee, under statutory authority to take a lease of a railroad, does not succeed to the prerogative franchises of the lessor.<sup>5</sup>

§ 226. **Rights of Lessee in Matter of Tolls.** — Upon the principle that a lessee corporation in operating a leased road exercises only derivative franchises,<sup>6</sup> it has been held that a lessee,

not. If that corporation had no right to use the land and may be restrained from operating its road, the lessee acquired no higher or superior right under its lease, which could not transfer privileges the lessor did not possess." See also *McMillan v. Michigan, etc. R. Co.*, 16 Mich. 79 (1867), (93 Am. Dec. 208).

<sup>1</sup> *London, etc. R. Co. v. South Eastern R. Co.*, 8 Ex. (W. H. & G.) 584 (1853).

<sup>2</sup> *Philadelphia, etc. R. Co. v. Catawissa R. Co.*, 53 Pa. St. 20 (1866).

<sup>3</sup> Where a railroad lease included all lands reasonably useful and convenient in operating a railroad, and another railroad company condemned a piece of land which might be useful although not then in use, it was held that the land was included in the lease and that the lessee was entitled to the use of the money awarded as damages for such taking, during the continuance of the lease. *Matter of New York, etc. R. Co.*, 49 N. Y. 414 (1872).

<sup>4</sup> See *ante*, § 157: "*Essential Franchises pass upon Sale of Railroad.*"

*Pennsylvania Co. v. Lake Erie, etc. R. Co.*, 146 Fed. 447 (1905): "As the complainant is lessee of the road its interest in the property is such as to give it the right to prevent by judicial process any illegal interference with its enjoyment of the leased property, and this right it may enforce by injunction."

A lessor corporation operating a railroad under a perpetual lease may file a petition to railroad commissioners with respect to the alteration of the road and the elimination of grade crossings.

*Town of Westbrook's Appeal from Commissioners*, 57 Conn. 95 (1889), (17 Atl. Rep. 368).

<sup>5</sup> See *ante*, § 210: "*Lessor Corporation retains Prerogative Powers. Right of Eminent Domain.*"

<sup>6</sup> Where one railroad company leases the rights and property of another railroad company, all corporate rights exercised by the lessor in the



in taking over the railroad of the lessor, is entitled to charge the rates of fare fixed by the charter of the lessor without regard to the rates prescribed in its own.<sup>1</sup>

But while the rates fixed in the owner's charter may limit — as a condition — the tolls collectible upon the leased road, the privilege of charging a greater rate of fare than authorized in the lessee's charter or in general laws applicable to it, can only be transferred by lease where the statute permits the transfer and the lease distinctly includes the privilege.<sup>2</sup>

§ 227. **Mortgages of Leases.** — A railroad corporation, having power to mortgage its property to secure its bonds, may mortgage its leasehold interest in a railroad, as well as other property, and such an interest will pass whenever comprehended, expressly or by implication, in the terms of the mortgage.<sup>3</sup> So, also, a leasehold interest in a railroad acquired after the execution of a mortgage may be included within its "after acquired property" clause whenever it clearly appears from the language that leasehold estates were intended to be embraced. Thus, a railroad mortgage covering "all the corporate rights, privileges, franchises, and immunities and all things in action, contracts, claims, and demands of the said party of the first part, whether now owned or hereafter acquired in connection or relating to said railroad," has been held to include a subsequently acquired lease of a connecting road.<sup>4</sup>

operation of the leased road are referable to the chartered rights of the lessor. *McCandless v. Richmond*, etc. R. Co., 38 S. C. 103 (1892), (16 S. E. Rep. 429, 18 L. R. A. 440).

<sup>1</sup> Where one railroad company leased the road of another with all its rights, powers, privileges, etc., it was held that the lessee, in using the lessor's road, was not subject to the charges fixed by its own charter as to toll, but to the regulations in the charter of the lessor. *Pennsylvania R. Co. v. Sly*, 65 Pa. St. 205 (1870). See also *Fisher v. New York*, etc. R. Co., 46 N. Y. 652 (1871).

A lease on the basis of a division of the net profits from the lessor's

and lessee's roads combined gives the lessor no claim on earnings from new roads subsequently built or acquired by the lessee. *Murch v. Eastern R. Co.*, 43 N. H. 515 (1862).

<sup>2</sup> See *ante*, § 161: "*Right to fix Rates of Fare. Chartered Rates.*"

The lessee can collect only the tolls stated in the lessor's charter though less than its own. *McGregor v. Erie R. Co.*, 35 N. J. L. 89 (1871).

<sup>3</sup> *Beekman v. Hudson River*, etc. R. Co., 35 Fed. 3 (1888).

The *Iowa* statute (Code 1897, § 2067), authorizes the mortgaging of leases to secure construction bonds.

<sup>4</sup> *Columbia*, etc. Co. v. *Kentucky Union R. Co.*, 60 Fed. 794 (1894).

Where a mortgage made by a railroad company provided that it should include all property subsequently acquired by the mortgagor, it was held that it included a railroad with its appurtenances subsequently leased, and that the title thereto was valid as against the assignee of the mortgagor.<sup>1</sup>

On the other hand, however, a lease executed by a mortgagor after the execution of a mortgage creates no privity of estate or contract between the mortgagee and the lessee, and a covenant of the lessee to make advancements cannot be treated as "after acquired property," within the meaning of that phrase as used in mortgages.<sup>2</sup>

§ 228. **Remedies of Lessee Corporation.** — The fact that a railroad company takes a lease of a railroad manifestly affects, in no way, its remedies against third persons.

The demands of a lessee against a lessor corporation depend upon the terms of the lease. In enforcing these demands and establishing its rights as lessee, a railroad company must, ordinarily, depend upon an action at law, but when this remedy is inadequate resort may be had to equity. Thus, where an attack was threatened upon the validity of a lease, under which a railroad company held a road forming a necessary part of its system, it was held that the company might maintain a bill in equity against the lessor corporation and its officers to establish the validity of the lease.<sup>3</sup>

## II. *Liabilities of Lessee Corporation*

§ 229. **Obligation of Lessee to perform Lessor's Public Duties.** — A lessee railroad company taking by lease the railroad, franchises and privileges of a lessor corporation, assumes its correlative duties and obligations. The burdens are insepa-

<sup>1</sup> *Barnard v. Norwich, etc. R. Co.*, 14 N. B. R. 469 (1876).

<sup>2</sup> *Moran v. Pittsburgh, etc. R. Co.*, 32 Fed. 878 (1887).

<sup>3</sup> *Southern R. Co. v. North Carolina R. Co.*, 81 Fed. 595 (1897). *State v. Mobile, etc. R. Co.*, 86 Miss. 172 (1905), (38 So. Rep. 732).

A lessee may intervene, as a party

defendant, in an action by the attorney-general to forfeit the charter of the lessor corporation, especially where, the interests of the lessor being protected by stipulations, there is reason to believe it is not unfriendly to the proceeding.

*People v. Albany, etc. R. Co.*, 77 N. Y. 232 (1879).

rable from the privileges.<sup>1</sup> The lessee assumes the obligations connected with the operation of the railroad contained in the lessor's charter and must conform to its requirements.<sup>2</sup> It must fulfil the conditions upon which the franchise was originally granted.<sup>3</sup>

A lessee corporation must, primarily, keep the road in operation.<sup>4</sup> Where the lessor, in consideration of a grant of State or municipal aid, has entered into an agreement to maintain the road in a certain location, the lessee must fulfil the obligation.<sup>5</sup> So, where the charter of the lessor provides for the

<sup>1</sup> Mayor, etc. v. Twenty-Third St. R. Co., 113 N. Y. 311 (1889), (21 N. E. Rep. 60); Chicago v. Evans, 24 Ill. 52 (1860).

<sup>2</sup> People v. St. Louis, etc. R. Co., 176 Ill. 512 (1898), (52 N. E. Rep. 292, 35 I. R. A. 656).

<sup>3</sup> Mullen v. Philadelphia Traction Co., 4 Pa. Co. Ct. Rep. 164 (1887).

<sup>4</sup> The law is clearly established that a railroad company may be compelled, by mandamus, to operate its railroad, and the underlying principles would seem to require the application of the same remedy where a lessee, after acquiring, under an authorized lease, a railroad and its franchises, fails to operate it. It has, however, been held that the lessee of a railroad under an *unauthorized* lease cannot be compelled by mandamus to operate it. See People v. Colorado, etc. R. Co., 42 Fed. 638 (1890).

<sup>5</sup> Chicago, etc. R. Co. v. Crane, 113 U. S. 424 (1885), (5 Sup. Ct. Rep. 578).

See also State v. Central Iowa R. Co., 71 Iowa, 410 (1887), (32 N. W. Rep. 409, 60 Am. Rep. 799).

A lessee corporation which has agreed to perform all the public obligations of the lessor, and which is of financial ability to do so, will be compelled to discharge such obligations notwithstanding the lessor may be financially unable to do so and it may entail loss upon the lessee. A lessor and lessee corporation which

have sought and obtained a charter imposing obligations cannot repudiate the latter merely because they are onerous or unprofitable. Thus where the charter of a railroad company required it to build its road to a certain town and, having leased its road, an amendment to the charter was obtained relieving it from this duty on condition that the right should be obtained from a third corporation owning a connecting road to run trains to said town over such road, it was held that the fact that the obtaining of such right would entail loss upon the lessee was no excuse for its failure to discharge the lessor's charter obligations.

Winchester, etc. R. Co. v. Commonwealth, 106 Va. 264 (1906), (55 S. E. Rep. 692).

Where it is the duty of a railroad company to maintain a depot at a county seat and it leases its railroad the lessee is bound to fulfil the same obligation and cannot avoid it by changing the line of the road.

State v. Mobile, etc. R. Co., 86 Miss. 172 (1905), (38 So. Rep. 732).

Where the charter of a railroad company provided that in case it should be necessary to change the location of any public road the company should, at its own expense, reconstruct the road in the most favorable location possible and in as perfect a manner as the original road, and it occupied a highway with a

payment of a certain percentage of the receipts to the State or to a city, the lessee is bound to make the payment.<sup>1</sup> Where a lessor corporation under its charter is not permitted to abridge its liability as a common carrier, the lessee operates the road subject to the same condition.<sup>2</sup>

A lessee corporation is not only bound to fulfil the public obligations of the lessor existing at the time of the lease, but is subject to laws subsequently enacted imposing duties with respect to the railroad leased.<sup>3</sup>

§ 230. **Statutory Liability of Lessee.** — Statutes have been enacted expressly providing that all duties imposed by law upon railroad companies shall be discharged by lessee corporations, and that all liabilities may be enforced against them.<sup>4</sup>

wall and embankment, but took no steps towards reconstruction and leased its road to another corporation, it was held that the lessee was bound to reconstruct the road. The Court said that the rights and franchises of the lessor corporation were not changed in character in passing to the lessee and that the latter in the exercise thereof assumed all the obligations of a public character imposed by the lessor's charter.

*Commonwealth v. Pennsylvania R. Co.*, 117 Pa. St. 637 (1888), (12 Atl. Rep. 38).

A statute requiring every railroad company operating a passenger railroad in the State to provide and maintain closets at each of its stations makes no distinction between lessor and lessee, and a lessee of a station from another company cannot avoid responsibility for failure to provide such closets upon the ground that the lessor company had agreed to perform the duty. *State v. So. Kansas R. Co.*, (Tex. Civ. App. 1907), 99 S. W. 167.

<sup>1</sup> Where the charter of a street railway company obliged it to pay one per cent of the fares received to the city in which it was located, and the company leased its railroad and franchises to another company, without

any provision in the lease imposing upon the lessee the obligation to pay the percentage, it was held that the lessee, upon taking the place of its lessor as to its charter rights and powers, took its place also as to its charter obligations and duties, and was not entitled to exercise the former without discharging the latter. *Mayor, etc. v. Twenty-Third St. R. Co.*, 113 N. Y. 311 (1889), (21 N. E. Rep. 60).

<sup>2</sup> *McMillan v. Michigan, etc. R. Co.*, 16 Mich. 102 (1867): "The power to lease does not imply the power to transfer greater rights than the lessor himself possesses; and where the obligations assumed by the lessor, pertaining to the management of his business, and the liabilities which would spring therefrom, were the consideration upon which the franchise was granted, it would be a violent inference that the legislature designed to waive them when they are no less important to the public protection after the lease than before."

<sup>3</sup> *Dryden v. Grand Trunk R. Co.*, 60 Me. 512 (1872).

<sup>4</sup> *Iowa*: Code 1897, § 2039. Another provision of the Iowa Code (§ 2066) is as follows: "Any . . . corporation operating the railway of another shall be liable in the same

Other statutes have been construed to apply to them as well as to lessor corporations.

As a general rule, statutes imposing duties upon railroad companies apply to the corporation actually operating the road. They are often applicable to the lessor corporation also — but the liability of the lessee is not thereby affected.

Statutes requiring railroad companies to fence their roads and to maintain cattle guards at crossings apply to lessee corporations, and they are held responsible for any failure to observe their provisions.<sup>1</sup>

manner and extent as though such railway belonged to it." For construction of this statute see *Stewart v. Chicago, etc. R. Co.*, 27 Iowa, 282 (1869); *Stephens v. Davenport, etc. R. Co.*, 36 Iowa, 327 (1873); *Bower v. Burlington, etc. R. Co.*, 42 Iowa, 546 (1876).

In *Indiana*, by statute, the lessee is solely liable when it operates the railroad in its own name. *Pittsburgh, etc. R. Co. v. Bolner*, 57 Ind. 572 (1877); *Pittsburgh, etc. R. Co. v. Hannon*, 60 Ind. 417 (1878), *Cincinnati, etc. R. Co. v. Bunnell*, 61 Ind. 183 (1878).

For additional statutory provisions prescribing the liability of lessees of railroad see:

*Arizona*: R. S. 1901, par. 864.

*Arkansas*: S. & H. Dig. 1894, §§ 6188, 6334.

*Georgia*: Code 1895, § 1863.

*Massachusetts*: Pub. St. ch. 112, § 5.

*Nebraska*: Comp. Stat. 1901, § 4020.

*Ohio*: Anno. Stat. (1787-1902), § 3305.

*Tennessee*: Code 1896, § 1539.

*Texas*: Sayles' Civ. Stat. 1897 (Supp. to 1900), vol. ii. ch. 15a (Acts 1899, p. 73).

In *Georgia* (Code 1895, § 2335), a lessee of any railroad may be sued in the same jurisdiction in which the lessor might have been sued.

<sup>1</sup> I. *Failure to maintain fences*:

*Ditchett v. Spuyten Duyvil, etc. R. Co.*, 67 N. Y. 425 (1876); *Tracy v. Troy, etc. R. Co.*, 38 N. Y. 433 (1868), (98 Am. Dec. 54); *Birchfield v. Northern Central R. Co.*, 57 Barb. (N. Y.) 589 (1870); *Clement v. Canfield*, 28 Vt. 302 (1856); *Cook v. Milwaukee, etc. R. Co.*, 36 Wis. 45 (1874); *McCall v. Chamberlain*, 13 Wis. 637 (1861); *Clary v. Iowa Midland R. Co.*, 37 Iowa, 344 (1873); *Downing v. Chicago, etc. R. Co.*, 43 Iowa, 96 (1876). The liability of a lessee is sometimes placed upon grounds of public policy. Thus, in *Illinois Cent. R. Co. v. Kanouse*, 39 Ill. 272 (1866), (89 Am. Dec. 307) the Court said, in substance, that the defendant was liable for using a defective road; that public policy required that it should be held responsible for injuries resulting from such use; that the fencing law was enacted for the public good and would be defeated if an irresponsible owner could lease an unfenced road to a responsible company which would not be liable for injuries; that the company using the road was *pro hac vice* the owner. See also *Toledo, etc. R. Co. v. Rumbold*, 40 Ill. (1866).

In *New York*, since 1890 (General Railroad Law, 1891 and 1892, § 32), both lessor and lessee are liable for want of fences. Prior to that statute the lessee was alone held liable. *Thorne v. Lehigh Valley R. Co.*, 8 Hun (N. Y.), 141 (1895), (34 N. Y.

Statutes fixing the liability of railroad corporations for damages by fire communicated by their locomotives also apply to lessee corporations.<sup>1</sup> In construing such a Massachusetts statute, Judge Ames, in *Davis v. Providence, etc. R. Co.*,<sup>2</sup> after reviewing cases holding the lessor responsible, said: "But there is nothing in these decisions, or in the reasons upon which they appear to rest, that confines the liability in such a case exclusively to the lessor, or that excludes the idea that the party injured may seek his remedy either of the lessor or the lessee. The case of the defendant comes literally within the terms of the statute. The fire was communicated from its engine. The damage was occasioned by its use of the road. . . . All the reasons, assigned in the above cited cases, for holding the corporation owning the road liable, apply with at least equal force to the corporation using the road and actually doing the mischief. Under such circumstances, the route for the time being may be considered as the route of the defendant; and there is no reason why it should not be held responsible for the damage caused by its use of the road, although the law has given to the injured party the right, if he sees fit, to seek his remedy against the corporation owning the road."

Supp. 525). See also *ante*, § 216: "*Lessor Corporation cannot avoid Statutory Obligations unless exempted.*"

The *Iowa* statute (Code 1897, § 2058) is as follows: "If the . . . lessee owning or engaged in the operation of any railroad in the State refuses or neglects to comply with any provision of this chapter relating to fencing of the tracks, it shall be guilty of a misdemeanor." Compare *Liddle v. Keokuk, etc. R. Co.*, 23 *Iowa* 378 (1867).

## II. Failure to maintain Cattle Guards:

In *Missouri Pacific R. Co. v. Morrow*, 32 *Kan.* 217 (1884), (4 *Pac. Rep.* 87, 19 *Am. & Eng. R. Cas.* 630), it was held, under a *Kansas* statute, that it is always the duty of a railway company operating a railroad to see

that proper cattle guards exist wherever its railroad enters or leaves improved or fenced lands, whether such railway company owns the railroad or is simply operating it under a lease.

An *Iowa* statute (Code 1897, § 2054) relates to cattle guards and holds all railroad companies (including lessees) liable for all damages occasioned by a failure to maintain them.

<sup>1</sup> *Pierce v. Concord R. Corp.*, 51 *N. H.* 590 (1872); *Davis v. Providence, etc. R. Co.*, 121 *Mass.* 134 (1876); *Cantlon v. Eastern R. Co.*, 45 *Minn.* 481 (1891), (48 *N. W. Rep.* 22). See also *Slossen v. Burlington, etc. R. Co.*, 60 *Iowa*, 215 (1882), (14 *N. W. Rep.* 244).

<sup>2</sup> *Davis v. Providence, etc. R. Co.*, 121 *Mass.* 134 (1876).

A lessee corporation holding under a long term lease has been held to the "proprietor" of the railroad, within the meaning of a New Hampshire statute relating to fires, and to be liable for damages sustained;<sup>1</sup> and has been held to be the corporation "owning the tracks," within the provisions of a statute imposing upon railroads whose tracks crossed at grade, the joint duty of making repairs and of maintaining a lookout at the crossing.<sup>2</sup>

A lessee corporation is also liable for injuries to travellers at highway crossings caused by a failure to equip its engines with statutory signals to warn them, and must observe other statutory provisions for the protection of the lives and property of the public.<sup>3</sup>

§ 231. **Liability of Lessee for Torts in Operation of Road under Authorized or Unauthorized Lease.** — A railroad company operating, under lease, the railroad of another corporation, is liable for injuries caused by its negligent or improper operation, to the same extent that the lessor would have been had it continued to operate the road;<sup>4</sup> and its liability is not affected by the fact that the lease may have been unauthorized and the lessor also responsible for the same acts or omissions.<sup>5</sup>

<sup>1</sup> *Pierce v. Concord R. Corp.*, 51 N. H. 590 (1872).

<sup>2</sup> *Baltimore, etc. R. Co. v. Worker*, 45 Ohio St. 577 (1888), (14 West. Rep. 172, 16 N. E. Rep. 475).

<sup>3</sup> A Massachusetts statute which required every railroad corporation to carry a bell on every engine passing upon "their road," etc., applied to a railroad corporation which had taken a lease of a railroad owned by another corporation and was running its own engines upon it under such lease. *Linfield v. Old Colony R. Corp.*, 10 Cush. (Mass.) 562 (1852), (57 Am. Dec. 124).

For construction of a Massachusetts statute (Pub. St. ch. 112, § 5), providing that a corporation lawfully maintaining and operating a railroad laid out and constructed by another corporation should be subject to the same duties and liabilities as if laid out

and constructed by itself, see *Nichols v. Boston, etc. R. Co.*, 174 Mass. 379 (1899), (54 N. E. Rep. 881).

<sup>4</sup> In *Sprague v. Smith*, 29 Vt. 425 (1857), (70 Am. Dec. 426), Chief Justice Redfield said: "It is well settled in practice, and by repeated decisions, that the lessees of railroads are liable to the same extent as the lessors would have been, while they continue to operate the road. . . . The party having independent control is, in general, liable for the acts of those under such control, whether in contract or tort."

<sup>5</sup> *Feital v. Middlesex R. Co.*, 109 Mass. 405 (1872), (12 Am. Rep. 720) (*per* Colt, J.): "The defendants were in actual possession and use of the track without objection from the owners or the Commonwealth; they assumed this responsibility to the plaintiff for a valuable consideration; and it is wholly immaterial, so far as

The lessee is liable for its own wrongs regardless of the liability of others, and its responsibility is usually placed upon this ground.<sup>1</sup> It may also be placed upon the ground that, in assuming the rights and franchises of the lessor to operate the road, the lessee assumes the correlative duty of operating it properly and the consequent liability for negligent operation.<sup>2</sup>

The obligation of a common carrier may be contractual, and a lessee corporation will be responsible for any damage arising from its breach of contract of carriage.<sup>3</sup> So, of course, the relations of the lessee corporation with its employees are contractual, and it is liable to them for any failure in the fulfillment of its obligations as master.<sup>4</sup> The lessee corporation

this action is concerned, that the lease was not legally made."

In *McCluer v. Manchester, etc. R. Co.*, 13 Gray (Mass.), 124 (1859), (74 Am. Dec. 624), it was held that a railroad company could not avoid liability for goods injured upon a railroad leased by it on the ground that the lease was void. The Court said (p. 129): "An innkeeper might as well resist the claim of a guest for compensation for the loss of his baggage, by suggesting doubts as to the validity of his landlord's title to the inn which he hired."

Where one railroad corporation has acquired, through judicial proceedings, the right to cross at grade the tracks of another company, a suit to enforce the decree in such proceedings is, in effect, to enjoin a continuing trespass upon the right acquired therein. In such a suit the lessee of the railroad whose tracks are crossed, and not the lessor, is an indispensable party.

*Baltimore, etc. R. Co. v. Wabash R. Co.*, 119 Fed. 678 (1902).

A lessee cannot be held liable for the torts of the lessor committed before the execution of the lease. *Pittsburgh, etc. R. Co. v. Kain*, 35 Ind. 291 (1871).

<sup>1</sup> *Wabash, etc. R. Co. v. Peyton*, 106 Ill. 534 (1883), (46 Am. Rep. 705); *Hall v. Brown*, 54 N. H. 495 (1874),

*Toledo, etc. R. Co. v. Rumbold*, 40 Ill. 143 (1866); *Philadelphia, etc. R. Co. v. Anderson*, 94 Pa. St. 351 (1880), (39 Am. Rep. 787; 6 Am. & Eng. R. Cas. 407); *St. Louis, etc. R. Co. v. Curl*, 28 Kan. 622 (1882), (11 Am. & Eng. R. Cas. 458).

<sup>2</sup> *Sprague v. Smith*, 29 Vt. 421 (1857), (70 Am. Dec. 424); *McMillan v. Michigan, etc. R. Co.*, 16 Mich. 79 (1867), (93 Am. Dec. 208); *Haff v. Minneapolis, etc. R. Co.*, 14 Fed. 558 (1882).

<sup>3</sup> *Wabash, etc. R. Co. v. Peyton*, 106 Ill. 534 (1883), (18 Am. & Eng. R. Cas. 1), (46 Am. Rep. 705); *Arrow-smith v. Nashville, etc. R. Co.*, 57 Fed. 165 (1893); *Philadelphia, etc. R. Co. v. Anderson*, 94 Pa. St. 351 (1880), (6 Am. & Eng. R. Cas. 407, 39 Am. Rep. 787).

In *Mahoney v. Atlantic, etc. R. Co.*, 63 Me. 68 (1873), and *Murch v. Concord R. Corp.*, 29 N. H. 1 (1854), it was held that the remedy of a passenger injured is against the company with which he contracts.

<sup>4</sup> The lessee of a continuous line of railroad is liable to suit by an employee for an injury received anywhere on the line, which may be brought at the general residence of the lessee corporation whether within or without the limits of the State where the injury occurred. *Watson*



is also liable for creating a nuisance, as well as for maintaining and continuing a nuisance created by the lessor.<sup>1</sup>

§ 232. **Joint Liability of Lessor and Lessee.** — As a general rule, in cases where, upon principles already considered, the lessor corporation is responsible for the negligence of the lessee, both corporations may be jointly sued and a joint judgment obtained.<sup>2</sup> A joint liability is also sometimes created by statute.<sup>3</sup>

The lessor and lessee corporations may be jointly liable for a nuisance — the former for creating, the latter for con-

*v. Richmond, etc. R. Co.*, 91 Ga. 222 (1892), (18 S. E. Rep. 306).

<sup>1</sup> *Ante*, § 217: "*Lessor cannot avoid Primary Obligations unless exempted.*"

In *Wasmer v. Delaware, etc. R. Co.*, 80 N. Y. 216 (1880), (1 Am. & Eng. R. Cas. 125, 36 Am. Rep. 608), where a railroad was improperly laid upon and along a street, the Court said: "The defendant cannot escape liability for this condition of the railroad, because it was simply the lessee of the road. It had the possession, the use and control of the road, and could not keep and maintain the rails in such a way in the street as to be dangerous to travellers thereon, and yet escape responsibility. He who knowingly maintains a nuisance is just as responsible as he who created it."

See also *Dickson v. Chicago, etc. R. Co.*, 71 Mo. 575 (1880); *Western, etc. R. Co. v. Cox*, 93 Ga. 561 (1894), (20 S. E. Rep. 68).

*Compare*, however, *Kearney v. New Jersey Central R. Co.*, 167 Pa. St. 362 (1895), (31 Atl. Rep. 637), where a lessee was held not liable for an overflow caused by an improperly constructed bridge.

*Compare* also another *Pennsylvania* case where it was held that a lessee, taking possession of and operating a leased road, is responsible for damages caused by a defective sewer under the road.

*Coyle v. Pittsburgh, etc. R. Co.*, 18 Pa. Super. Ct. 235 (1901).

Where the lessee of a railroad makes a change in a culvert built by the lessor which results in damage, the lessee is liable therefor.

*Shores v. Southern R. Co.*, 72 S. C. 244 (1905), (51 S. E. Rep. 699).

See also *ante*, § 217: "*Lessor cannot avoid Primary Obligations unless exempted.*"

<sup>2</sup> *Pennsylvania Co. v. Ellet*, 132 Ill. 654 (1890), (24 N. E. Rep. 559). In this case the plaintiff recovered a joint judgment against both defendants — lessor and lessee. *Compare*, however, *Spangler v. Atchison, etc. R. Co.*, 42 Fed. 307 (1890), where the Court said: "It may also be conceded that both are liable. But the action is joint as well as several. The plaintiff had the right to proceed against either one of them, and would be entitled in the joint action to take judgment against one, and dismiss as to the other." See also *Logan v. North Carolina R. Co.*, 116 N. C. 940 (1895), (21 S. E. Rep. 959).

<sup>3</sup> In *Ohio* (Anno. Stat. 1787-1902, § 3305), it is provided that lessor and lessee may be jointly sued for negligence. This statute is construed in *Staltz v. Baltimore, etc. R. Co.*, 7 Ohio N. P. 129 (1897). For construction of an *Iowa* statute, see *Stephen v. Davenport, etc. R. Co.*, 36 Iowa, 327 (1873); *Clary v. Iowa Midland R. Co.*, 37 Iowa, 344 (1873).

tinuing it.<sup>1</sup> A separate liability, as has been shown, also exists.<sup>2</sup> So, where both lessor and lessee participate in the management of a railroad, they are jointly and severally liable for injuries caused by the negligence of employees, for the employees are as much the servants of the one as of the other.<sup>3</sup> And where a railroad is operated under an unauthorized lease, the lessee becomes the agent of the lessor in such operation, and the general principle is applicable that the liability for negligence of principal and agent may be enforced in a suit against either or both.<sup>4</sup> The lessor and lessee may also, in such a case, be held jointly liable, upon the ground that they are undertaking an unlawful enterprise and are wrongfully usurping powers.

This general rule also, undoubtedly, applies in the case of an authorized lease, without an exemption clause in those States where an express grant of immunity is necessary to relieve a lessor from liability for the negligence of its lessee. It should be observed, however, that this application of the rule renders a railroad company which makes a lease, with the approval of the State, a joint *tortfeasor* in the operation of a road over which it has no control.<sup>5</sup>

<sup>1</sup> *Stickley v. Chesapeake, etc. R. Co.*, 93 Ky. 323 (1892), (20 S. W. Rep. 261).

In *Railroad Co. v. Hambleton*, 40 Ohio St. 503 (1884), (14 Am. & Eng. R. Cas. 126), the Supreme Court of Ohio said: "Numerous cases are referred to by counsel for the plaintiff in error involving the liability of lessor and lessee. But most of them are cases involving the separate liability of lessor and lessee. This case involves the joint liability of lessor and lessee, and this class of liability is clearly applicable to a person who creates a nuisance jointly with him who continues it."

<sup>2</sup> *Ante*, § 217: "Lessor cannot avoid Primary Obligations unless exempted."

<sup>3</sup> In *Nashville, etc. R. Co. v. Carroll*, 6 Heisk. (Tenn.) 357 (1871), the Court said: "The principle is, that where one has the exclusive control and man-

agement of the train, whether owner or not of the cars, it is responsible for damages for wrongs; and if this be so, it follows, necessarily, that if, in fact, that control be joint, and the train jointly under the control of agents of the two companies, then both must be held responsible. Two persons may be joint masters, and thereby subject to a joint liability for the acts of servants or employees; and such joint liability may be converted into a several liability by the election of the plaintiff to sue only one, which may be done in such a case."

See also *Railroad Co. v. Brown*, 17 Wall. (U. S.) 445 (1873). Also *ante*, § 221: "Liability of Lessor for Negligent Operation of Railroad — (D) When it shares in Control."

<sup>4</sup> *Cooley on Torts*, p. 165.

<sup>5</sup> Even if the lessor and lessee under an authorized lease are joint *tort*

§ 233. **Liability of Lessee for Debts of Lessor.** — A railroad company taking under lease, in good faith, the railroad and franchises of another corporation, assumes, as a general rule, no responsibility for the unsecured debts of the latter. Where, however, the lease embraces the entire property of a lessor corporation in debt, of the existence of which indebtedness the lessee has notice, it may, upon the principle that the property of a corporation constitutes a trust fund for the payment of its debts, be chargeable as a trustee and compelled to apply the property so received in payment of the debts of the lessor.<sup>1</sup> And even without bad faith on the part of the lessor or lessee, where the entire property of a corporation having debts is transferred, under a lease permitting the lessee to dispose of a portion of the leased property and apply the proceeds, not only for the improvement of the remaining property but for its own benefit — thus preventing any application for the satisfaction of debts — and the lessee makes such sale and application, a court of equity will decree the payment of a judgment debt of the lessor by the lessee.<sup>2</sup> In such a case

*feasors* it is certain that the rule which forbids contribution among wrongdoers is inapplicable in favor of a lessee.

<sup>1</sup> *Mellen v. Moline Iron Works*, 131 U. S. 352 (1889), (9 Sup. Ct. Rep. 781); *Central R. Co. v. Pettus*, 113 U. S. 116 (1885), (5 Sup. Ct. Rep. 387).

<sup>2</sup> In *Chicago, etc. R. Co. v. Third National Bank*, 134 U. S. 276 (1890), (10 Sup. Ct. Rep. 550), *affirming* 26 Fed. 820 (1886), where a railroad company, heavily in debt, leased all its property to another company for nine hundred and ninety-nine years; and also executed a deed of trust securing bonds to a large amount which were to be sold for the payment of existing liens and for the benefit of the lessee, and the bonds were so sold and applied, among other things, for the building of a bridge for the lessee's benefit, the Supreme Court of the United States said (p. 286): "The contracting parties arranged not merely for the discharge of the foreclosure lien, but for

the completion of the road for which the lessor's franchise was granted. The lessee not only performed these stipulations, but, with moneys arising from the sale of these bonds, built, for its own benefit, a bridge across the Mississippi River, connecting this road with its line in Iowa, and thus making a continuous line of road to Omaha. Neglecting to pay the debts of the lessor, it appropriated a large amount of the proceeds of the trust deed upon the lessor's property to its own benefit, and the improvement of its own property. Here clearly was a diversion of funds, which the creditors of the lessor might follow in equity. This is only the application of familiar doctrine. The properties of a corporation constitute a trust fund for the payment of its debts; and, when there is a misappropriation of the funds of a corporation, equity, on behalf of the creditors of such corporation, will follow the funds so diverted."

the lessee corporation is liable, not as lessee, but as a trustee which has diverted funds due creditors to its own use.

A lessee corporation may, as a part of the consideration of the lease, assume and agree to pay the debts of the lessor. In such a case, the weight of authority supports the view that the lessee may be held directly liable to creditors of the lessor upon the assumption clause.<sup>1</sup>

## CHAPTER XXI

### RAILROAD LEASES UNDER RECEIVERSHIP

- § 234. Receiver not Assignee of the Term. May not abrogate Leases as between Parties.
- § 235. Receiver may elect within Reasonable Time to assume or renounce Lease.
- § 236. Obligations of Receiver pending Election.
- § 237. Obligations of Receiver after Election.
- § 238. Lease of Railroad by Receiver.

**§ 234. Receiver not Assignee of the Term. May not abrogate Leases as between Parties.** — The appointment of a receiver of the property of a railroad company, by a court of equity,<sup>2</sup> does not change the title to the property or even the right of possession. The receiver takes the property, including leasehold interests, merely as a custodian for the court from

<sup>1</sup> See *ante*, § 123: "*Liability of Purchasing Corporation for Debts of Vendor Company.*"

For cases illustrating assumption of debts of lessor by lessee corporation, see *Mississippi, etc. R. Co. v. Southern R. Ass'n*, 7 Baxt. (Tenn.) 595 (1874), (11 Am. & Eng. R. Cas. 576); *Pennsylvania Co. v. Erie, etc. R. Co.*, 108 Pa. St. 621 (1885), (29 Am. & Eng. R. Cas. 549).

<sup>2</sup> In some of the States, as in New York, a certain class of receivers are, by statute, invested with the estate

of an insolvent with, substantially, the powers of trustees in bankruptcy. Such statutes are, however, generally inapplicable to railroad companies, and the receivers referred to in this chapter are those appointed according to the course of equity. See *Quincy, etc. R. Co. v. Humphreys*, 145 U. S. 82 (1892), (12 Sup. Ct. Rep. 787), and *Gaither v. Stockbridge*, 67 Md. 222 (1887), (9 Atl. Rep. 632). Also *Booth v. Clark*, 17 How. (U. S.) 322 (1854).

which he derives his authority; he does not become an assignee of the unexpired term of the leasehold estate.<sup>1</sup> As said by the Supreme Court of Maryland,<sup>2</sup> in language approved by the Supreme Court of the United States:<sup>3</sup> "If the order of the court, under which the receiver acts, embraces the leasehold estate, it becomes his duty, of course, to take possession of it. But he does not, by taking such possession, become the assignee of the term, in any proper sense of the word. He holds that as he would hold any other personal property involved, — for and as the hand of the court, and not as assignee of the term."

The intervention of a court of equity for the preservation of property involved in litigation by putting it into the hands of a receiver — a ministerial officer — not only makes no change in the title but alters no lien or contract. A contract

<sup>1</sup> Quincy, etc. R. Co. v. Humphreys, 145 U. S. 82 (1892), (12 Sup. Ct. Rep. 787), *affirming sub nom.* Central Trust Co. v. Wabash, etc. R. Co., 34 Fed. 259 (1888); Union Bank of Chicago v. Kansas City Bank, 136 U. S. 223 (1890), (10 Sup. Ct. Rep. 1013); Central Trust Co. v. Continental Trust Co., 86 Fed. 517 (1898); Empire Distilling Co. v. McNulta, 77 Fed. 700 (1897), *affirmed sub nom.* Dennehy v. McNulta, 86 Fed. 825 (1898), (41 L. R. A. 609); Carswell v. Farmers Loan, etc. Co., 74 Fed. 88 (1896); Ames v. Union Pacific R. Co., 60 Fed. 966 (1894); New York, etc. R. Co. v. New York, etc. R. Co., 58 Fed. 268, 280 (1893); Park v. New York, etc. R. Co., 57 Fed. 799 (1893); Bell v. American Protective League, 163 Mass. 558 (1895), (40 N. E. Rep. 857, 47 Am. St. Rep. 481); Gaither v. Stockbridge, 67 Md. 222 (1887), (9 Atl. Rep. 632). *Compare*, however, United States Trust Co. v. Wabash Western R. Co., 150 U. S. 287 (1893), (14 Sup. Ct. Rep. 86), where Mr. Justice Brown apparently overlooks the language of Mr. Chief Justice Fuller in Quincy, etc. R. Co. v. Humphreys, *supra*, and considers a

receiver as standing in the same position as an assignee. In Brown v. Toledo, etc. R. Co., 35 Fed. 444 (1888), Judge Gresham, in view of the nature of the proceedings, treated the receiver as an assignee of the term, but that decision has been criticised in later cases. New York, etc. R. Co. v. New York, etc. R. Co., 58 Fed. 268 (1893). *Compare* also Commonwealth v. Frankfort Ins. Co., 115 Mass. 278 (1874); Frank v. New York, etc. R. Co., 122 N. Y. 197 (1890), (25 N. E. Rep. 232).

A claim for unpaid rentals due a lessor corporation before the appointment of a receiver for the lessee corporation cannot be established as an equitable lien upon a fund in the hands of the receiver arising from the operation of the road during the receivership — no part of the rental withheld by the lessee having been received by the receiver.

Cox. v. Terre Haute, etc. R. Co., 133 Fed. 371 (1904).

<sup>2</sup> Gaither v. Stockbridge, 67 Md. 224 (1887), (9 Atl. Rep. 632).

<sup>3</sup> Quincy, etc. R. Co. v. Humphreys, 145 U. S. 98 (1892), (12 Sup. Ct. Rep. 787).

of lease is not affected by the appointment of a receiver, nor is the right of the lessor corporation to insist upon performance or forfeiture in any way impaired. The lease remains in full force until terminated by the parties, and the receiver has no power to abrogate it as between them. "It is not in the power of such receivers to annul or abrogate such a lease as between the lessor and lessee company."<sup>1</sup>

§ 235. **Receiver may elect within Reasonable Time to assume or renounce Lease.** — When a receiver of a railroad company, having leased lines, is appointed, it is necessary, in order to keep the entire system a going concern, that he should take possession of and operate the leased roads, as well as the other roads of the system. The public duties of the corporations — lessor and lessee — must be performed; their obligations, to the government in carrying the mails, to the public as common carriers, must be fulfilled without interruption, and this result can only be obtained by putting the receiver into temporary possession of the leasehold interests. The mere act of taking possession, however, does not constitute an adoption of the lease by the receiver nor render him liable upon its covenants, and he is entitled to a reasonable time — a breathing spell — to determine whether he will assume or renounce the lease.<sup>2</sup>

<sup>1</sup> New York, etc. R. Co. v. New York, etc. R. Co., 58 Fed. 280 (1893), *per* Lurton, J. In *Park v. New York, etc. R. Co.*, 57 Fed. 802 (1893), Judge Lacombe said: "The right to insist upon the execution of this contract according to its terms — the right to refuse further use and possession of that property to any one who will not or cannot make such payments — is in no way impaired by the fact that the court has taken possession of all the property owned and held by the Erie Company, to administer the same for the interests of all concerned, and has placed its officers, the receivers, as custodians and caretakers, not only to preserve the same, but also to maintain it as a going concern pending the final adjustment."

A receiver cannot, by agreement with the lessor company, abrogate a

lease, pending receivership, without the consent of the court. In determining the matter, the court will take into consideration the situation of the parties at the time the receiver is appointed. *Day v. Postal Tel. Co.*, 66 Md. 354 (1886), (7 Atl. Rep. 608).

<sup>2</sup> A receiver, appointed by order of a court of equity, is obliged to take possession of a leasehold estate, if it be included within the order of the court; but he does not, thereby, become the assignee of the term or liable for the rent, but holds the property as the hand of the court and is entitled to a reasonable time to ascertain its value, before he can be held to have accepted it as lessee. *Quincy, etc. R. Co. v. Humphreys*, 145 U. S. 82 (1892), (12 Sup. Ct. Rep. 787). In so holding Mr. Chief Justice Fuller said (p. 101): "The court did not bind itself or its

As said by Judge Lurton in *Carswell v. Farmers Loan, etc. Co.*:<sup>1</sup> "A receiver may take and retain possession of leasehold interests for such reasonable time as will enable him to intelligently elect whether the interest of his trust will be best subserved by adopting the lease, and making it his own, or by returning the property to the lessor."

What constitutes a reasonable time, within which a receiver must elect, depends to such an extent upon the facts and circumstances appearing in any particular case, that no general rule can be laid down for determining it.<sup>2</sup>

receivers *eo instanti* by the mere act of taking possession. Reasonable time had necessarily to be taken to ascertain the situation of affairs. The Quincy Company, as a *quasi*-public corporation operating a public highway, was under a public duty to keep up and maintain its railroad as a going concern, as was the Wabash Company under the contract between them, but the latter had become unable to perform the public service for which it had been endowed with its faculties and franchises, and which it had assumed to discharge as between it and the other company. Its operation could only be continued under the receivers, whose action in that respect cannot be adjudged to have been dictated by the idea of keeping the property in order to sell it, or using it to the advantage of the creditors, or doing otherwise than 'abstain from trying to get rid of the property.'"

See also *United States Trust Co. v. Wabash Western R. Co.*, 150 U. S. 287 (1893), (14 Sup. Ct. Rep. 86); *Seney v. Wabash Western R. Co.*, 150 U. S. 310 (1893), (14 Sup. Ct. Rep. 94); *St. Joseph, etc. R. Co. v. Humphreys*, 145 U. S. 105 (1892), (12 Sup. Ct. Rep. 795); *Sunflower Oil Co. v. Wilson*, 142 U. S. 313 (1892), (12 Sup. Ct. Rep. 235); *Central Trust Co. v. Continental Trust Co.*, 86 Fed. 517 (1898); *Mercantile Trust Co. v. Farmers Loan, etc. Co.*, 81 Fed. 254 (1897); *Empire Distilling Co. v. McNulta*, 77 Fed.

700 (1897); *Carswell v. Farmers Loan, etc. Co.*, 74 Fed. 88 (1896); *Ames v. Union Pacific R. Co.*, 60 Fed. 966 (1894); *Farmers Loan, etc. Co. v. Northern Pacific R. Co.*, 58 Fed. 257 (1893); *New York, etc. R. Co. v. New York, etc. R. Co.*, 58 Fed. 268 (1893); *Park v. New York, etc. R. Co.*, 57 Fed. 799 (1893); *Bell v. American Protective League*, 163 Mass. 558 (1895), (40 N. E. Rep. 857, 47 Am. St. Rep. 481).

An agreement that the receipt of less than full rental for leased property shall be without prejudice to a claim for the balance, or the lessor's right to forfeit the lease, makes the receiver hold under the agreement, and not under the lease, so that his continued possession does not amount to an adoption of the lease. *Thomas v. Cincinnati, etc. R. Co.*, 77 Fed. 667 (1896).

<sup>1</sup> *Carswell v. Farmers Loan, etc. Co.*, 74 Fed. 91 (1896).

<sup>2</sup> Receivers of a lessee railroad company are not bound, merely by their appointment, to assume all its leases; but they have a reasonable time in which to determine whether they will assume or renounce them. And where numerous contracts are to be examined, a delay of 65 days before renouncing a lease is not unreasonable. *Ames v. Union Pacific R. Co.*, 60 Fed. 966 (1894).

In *Quincy, etc. R. Co. v. Humphreys*, 145 U. S. 82 (1892), (12 Sup. Ct. Rep. 787), one month was said to be

It is not necessary in order to charge the receiver that he should have formally elected to assume the lease. His possession of the leased property might be continued for such a period and under such circumstances as would, in law, be equivalent to an election.<sup>1</sup> Thus, receivers of a leased railroad, who for a long time continued to operate the leased line, and issued receivers' certificates to raise money for paying taxes thereon according to the provisions of the lease, were held to have adopted the lease, and to be liable to repay to the lessor taxes on the leased line which it had been compelled to pay by the judgment of a competent court.<sup>2</sup> Where the question of the renunciation or adoption of a lease has been by a receiver submitted to and determined, after due consideration, by the court appointing him, its decision, being upon a question of business policy and not of law, and administrative rather than judicial in its nature, will not be disturbed by an appellate court, unless it appears that the discretion of the lower court has been abused.<sup>3</sup>

If the receiver elect to adopt a lease, he becomes vested with the title to the leasehold interest, and a privity of estate is thereby created between the lessor and the receiver by which the latter becomes liable upon the covenant to pay rent.<sup>4</sup>

§ 236. **Obligations of Receiver pending Election.** — As already shown, the appointment of a receiver of a lessee cor-

a reasonable time in which to make an election to accept or surrender a lease. In *St. Joseph, etc. R. Co. v. Humphreys*, 145 U. S. 105 (1892), (12 Sup. Ct. Rep. 787), under somewhat extraordinary circumstances, a period of nine months was held not to be an unreasonable time. In *Park v. New York, etc. R. Co.*, 57 Fed. 799 (1893), two weeks was said not to be unreasonable. A period of ten months, during all of which time negotiations were being carried on for a reduction of the rental, was held in *Carswell v. Farmers Loan, etc. Co.*, 74 Fed. 88 (1896), to be a reasonable time.

<sup>1</sup> *Empire Distilling Co. v. McNulta*, 77 Fed. 700 (1897), and cases cited.

<sup>2</sup> *United States Trust Co. v. Mer-*

*cantile Trust Co.*, 88 Fed. 140 (1898).

<sup>3</sup> *Mercantile Trust Co. v. Farmers Loan, etc. Co.*, 81 Fed. 254 (1897).

Disputed questions of fact as to whether a receiver has renounced or assumed a lease must be determined by action and not by mere petition in the receivership cause.

*People v. Erie R. Co.*, 54 How. Pr. 59 (1877). See also *Woodruff v. Erie R. Co.*, 93 N. Y. 609 (1883).

A receiver will not be ordered to assume a lease merely because the company he represents is solvent. *Empire Distilling Co. v. McNulta*, 77 Fed. 700 (1897).

<sup>4</sup> *Mercantile Trust Co. v. Farmers Loan, etc. Co.*, 81 Fed. 254 (1897).



poration does not work an assignment of the lease or render him liable upon the covenants therein. While the receiver may operate the leased railroad for a reasonable time in order to determine whether he will adopt the lease, he does not, as a general rule, thereby become liable for the stipulated rent for such period, in case he finds the road unprofitable, and, with the approval of the court, surrenders it to its owner.<sup>1</sup> He

<sup>1</sup> In *Quincy, etc. R. Co. v. Humphreys*, 145 U. S. 98 (1892), (12 Sup. Ct. Rep. 787), Mr. Chief Justice Fuller said: "But appellants insist that, without regard to privity of estate or privity of contract, receivers in chancery are liable, not for a reasonable rental value during the occupancy of leased property committed to their charge by order of court, but for rental according to the covenants of the leases whenever there are unequivocal acts of use and control of such property; and that they thus adopt the leases and become bound by their terms so long as such use and control continue. . . . Clearly, this was no case of the employment of the property of another for one's own benefit. Within a month, the receivers applied to the court for instructions, distinctly setting forth that there was no income wherewith to pay the rental in question, and the order of court, entered at once, proceeded under the theory that they were not to be bound by the rental prescribed. . . . We do not discover any equitable ground upon which appellants are entitled to a preference in the distribution of the proceeds of the sale of the mortgaged property. The cost of the maintenance of the Quincy road by the receivers exceeded its total earnings; and the net earnings of the whole Wabash system, before the Quincy Company retook its road, did not amount to one quarter of the amount of preferred debt existing when the receivers were appointed. The property was surrendered to it

freed from any charge for that debt, to the payment of which it contributed nothing."

An order directing receivers to keep divisional accounts, and to pay rental on leased lines only to the extent of any surplus earned by them, is notice to such lines that they must not expect payment of rentals unless there is a surplus; and if they do not then intervene to regain possession of the property, they have no claim on the receivers in the event that there is no surplus. *United States Trust Co. v. Wabash Western R. Co.*, 150 U. S. 287 (1893), (14 Sup. Ct. Rep. 86); *Seney v. Wabash Western R. Co.*, 150 U. S. 310 (1893), (14 Sup. Ct. Rep. 94).

Receivers have, as a general rule, a reasonable time in which to determine whether they will adopt the lease, or will merely pay to the lessor the net earnings of its road, subject, always, to the lessor's right to re-enter for condition broken. *Farmers Loan, etc. Co. v. Northern Pacific R. Co.*, 58 Fed. 257 (1893).

The expenses and deficits incurred by receivers in operating a railroad under a lease which it was their duty to renounce are chargeable to the leased road, and not to the receivers, where they have not assumed the lease. *Mercantile Trust Co. v. Farmers Loan, etc. Co.*, 81 Fed. 254 (1897).

A lessor corporation has no preferred claim for rentals accruing during receivership where it did not demand either possession, or confirmation of lease by receiver. *New*

must, however, deal fairly with the lessor and is bound to turn over the net earnings of the road, if less than the stipulated rent, to the lessor, and to pay a reasonable rental for leased property, in itself non-producing.<sup>1</sup> This is equitable. The

York, etc. R. Co. v. New York, etc. R. Co., 58 Fed. 268 (1893).

See also as sustaining general principle stated in text: *St. Joseph, etc. R. Co. v. Humphreys*, 145 U. S. 105 (1892), (12 Sup. Ct. Rep. 987); *Milwaukee, etc. R. Co. v. Brooks, etc. Works*, 121 U. S. 430 (1887), (7 Sup. Ct. Rep. 1094); *Park v. New York, etc. R. Co.*, 57 Fed. 799 (1893); *Ames v. Union Pacific R. Co.*, 60 Fed. 966 (1894); *Bell v. American Protective League*, 163 Mass. 558 (1895), (40 N. E. Rep. 857, 47 Am. St. Rep. 481).

*Contra*, however, *Woodruff v. Erie R. Co.*, 93 N. Y. 609 (1883), where the New York Court of Appeals held that a receiver could not take possession of a leased railroad and enjoy its use and occupation, without incurring liability for the rent reserved.

And in *Frank v. New York, etc. R. Co.*, 122 N. Y. 197 (1890), (25 N. E. Rep. 232) it was again held that the principles governing the liability of an assignee of a lease apply in the case of a receiver of the property of the lessee, and that he is chargeable with the payment of the rent reserved for such time as he occupies the leased property.

See also *Mercantile, etc. Co. v. Southern, etc. R. Co.*, 113 Ala. 543 (1897), (21 So. Rep. 373); *Brown v. Toledo, etc. R. Co.*, 35 Fed. 444 (1888).

<sup>1</sup> See cases cited in preceding note. Also *Carswell v. Farmers Loan, etc. Co.*, 74 Fed. 88 (1896), where a receiver of a railroad retained possession of leased depot property for ten months, with the assent of the depot company, negotiations being all the time in progress to fix a reasonable rent. At the end of this time,

a receiver of the depot company was appointed. It was held that the railway receiver had not elected to adopt the lease, and was liable only for a reasonable rent of the depot, not for the stipulated rental.

And see *Savannah, etc. R. Co. v. Jacksonville, etc. R. Co.*, 79 Fed. 35 (1897).

Where a mortgage trustee notified the lessor upon taking possession that he repudiated the lease but would pay fair compensation the court upheld the notice. *Milwaukee, etc. R. Co. v. Brooks, etc. Works*, 121 U. S. 430 (1887), (7 Sup. Ct. Rep. 1094).

A lessee railroad company became insolvent and a receiver was appointed who took possession of the leased road. Thereafter, and during almost the entire period of the receivership, the lease was practically abrogated and while the leased road was operated by the receiver in connection with the insolvent road it was for its own benefit. Upon the sale of the insolvent road a settlement was made with the lessor and a fund was set apart as a result of the operation of the leased road. Stockholders of the lessor corporation who were entitled under the lease to the rental by way of dividends brought suit for "back rentals" and it was held that they were only entitled to dividends out of such fund for the time during which the road was operated before the abrogation of the lease, and not to the balance which, under the settlement, went directly to the lessor corporation and not as a dividend to its stockholders.

*Farrar v. South Western R. Co.*, 116 Ga. 337 (1902), (42 S. E. Rep. 527).

receiver operates the leased road subject to the right of the lessor to re-enter for condition broken and to insist upon an immediate adoption of the lease or surrender of the road. If the lessor fail to assert his right, it may fairly be presumed that the trial of the road by the receiver is of as much importance to him as to the receiver, and there is no reason why the receiver should hazard the *corpus* of his estate by the experiment.

Where, however, the lessor, immediately upon the appointment of the receiver, demands of the receiver and of the court, either an assumption of the lease or a surrender of the road, and the decision is long delayed that the receiver may determine which policy is expedient, he must pay the stipulated rent for the time he has had possession, in case he elects to surrender the road.<sup>1</sup> So, where a receiver operates a leased road and keeps no separate accounts showing the net earnings of the road, he must pay the rent stipulated for the time of his possession although he renounces the lease.<sup>2</sup> In such cases, equity establishes exceptions to the general rule.

§ 237. **Obligations of Receiver after Election.** — When, after due investigation, a receiver elects, and the court, after consideration, determines to surrender a leasehold interest to its owner and such surrender is made and compensation for the use pending election is paid according to the principles just indicated the connection of the receiver with the leased prop-

<sup>1</sup> In *Farmers Loan, etc. Co. v. Northern Pacific R. Co.*, 58 Fed. 265 (1893), Judge Jenkins said: "So that here the lessors have been continuously knocking at the door of the court, demanding possession of the demised premises, and possession has been withheld from them against their consent, and against their protest. It appears to the court that, under such circumstances, it would be inequitable to say that the court or its receivers should hold possession of the demised premises, refusing to pay rent accruing before the receivership, taking from the lessor their estate without their consent, express or implied, and saying to

them: 'While we take and withhold that possession until it shall be satisfactorily determined whether it is profitable or not to operate the road, you, the lessee, shall not have your rental pending that determination according to the stipulations of the lease under which possession was taken.'"

<sup>2</sup> *Central, etc. Co. v. Farmers Loan, etc. Co.*, 79 Fed. 158 (1897).

Where a receiver operates leased lines for a year, and uses the earnings to pay interest, the court will order him, to that extent, to pay taxes on the road as required by the terms of the lease. *Clyde v. Richmond, etc. R. Co.*, 63 Fed. 21 (1894).

erty terminates; but when the receiver, with the approval of the court, decides not to surrender the lease and so notifies the lessor and continues in possession of the leased property, such acts constitute an adoption of the lease and carry with it an obligation to fulfil the covenants of the lease and to pay the rental stipulated.<sup>1</sup> Thus, where a receiver adopts a lease containing provisions for the purchase of the property leased, he is bound by the instrument.<sup>2</sup>

When a receiver is operating a railroad system consisting of many leased lines, the leases of which have been adopted, the accounts of each line should be kept separately, and the outlay of each reduced, if possible, until it pays operating expenses; but if the receiver is unable to do so, receiver's certificates on the whole system may be issued to make up the deficiency.<sup>3</sup> So, where a receiver has been unable to obtain money for the payment of rentals, the court on final decree may properly declare the unpaid rentals a first lien on the property and direct that the same, with interest, be paid out of the proceeds of the sale as a preferential lien.<sup>4</sup>

<sup>1</sup> Central Trust Co. v. Continental Trust Co., 86 Fed. 517 (1898).

See also *Easton v. Houston, etc. R. Co.*, 38 Fed. 784 (1889); *Mercantile, etc. Co. v. Southern, etc. Co.*, 113 Ala. 543 (1897), (21 So. Rep. 373). *Spencer v. World's Columbian Exposition*, 163 Ill. 117 (1896), (45 N. E. Rep. 250).

Where a lessee corporation agreed to pay, as a part of the rental, the interest on certain bonds, the holders of such bonds, on the appointment of a receiver by a federal court for such corporation, were permitted to come in and directly assert their claims for interest against the fund in the hands of the court for the payment of rentals, notwithstanding the appointment of a receiver for the lessor corporation, with power to collect the rentals. *Mercantile Trust Co. v. Baltimore, etc. R. Co.*, 94 Fed. 722 (1899).

See also *Grand Trunk R. Co. v. Central Vermont R. Co.*, 78 Fed. 690

(1897), *affirmed sub nom.* *Bank v. Smith*, 86 Fed. 398 (1898).

As to submission of amount of increased rental due to improvements to arbitration see *Farmers Loan, etc. Co. v. Chicago, etc. R. Co.*, 18 Fed. 484 (1883), *affirmed sub nom.* *Peoria, etc. R. Co. v. Chicago, etc. R. Co.*, 127 U. S. 200 (1888), (8 Sup. Ct. Rep. 1125).

<sup>2</sup> *Mercantile Trust Co. v. Atlantic, etc. R. Co.*, 80 Fed. 18 (1897).

<sup>3</sup> *Central Trust Co. v. Wabash, etc. R. Co.*, 23 Fed. 863 (1885). See also *Miltenberger v. Logansport R. Co.*, 166 U. S. 286 (1882), (10 Sup. Ct. Rep. 140).

<sup>4</sup> *Central Trust Co. v. Continental Trust Co.*, 86 Fed. 517 (1898).

Where a railroad lease is declared void the lessor has no right to a *quantum meruit* against funds in hands of receiver, the operation of the leased road having been a source of loss. *St. Louis, etc. R. Co. v. Cleveland, etc. R. Co.*, 125 U. S. 658 (1888), (8 Sup.

Where, however, the court in authorizing a receiver to operate a leased line provides that the rent shall be paid only after certain prior payments have been made, the lessor cannot claim payment from the receiver absolutely.<sup>1</sup> The lessor may re-take its road if dissatisfied with the provisions of the order, but its only demand against the receiver is in accordance with the order.

Where a receiver makes a valid contract for repairs on leased rolling stock, he is liable thereon as receiver, although it is subsequently turned over to another receiver.<sup>2</sup>

§ 238. **Lease of Railroad by Receiver.** — As a railroad corporation cannot, itself, lease its railroad and franchises, without legislative authority, a receiver who temporarily assumes its functions does not, without like authority, possess the power.<sup>3</sup> The necessary authority is legislative, not judicial, and in order to justify a lease by receivers some statutory provision must confer the right to execute it.

Courts have, however, sometimes authorized receivers appointed by them to *take* leases of railroads, — generally short connecting lines, — where the interest of the creditors and the corporation required it.<sup>4</sup> Upon the principle that legislative authority is as necessary to take as to make a lease, it is assumed that such orders have been passed only where some general or special law authorized the connection, by lease, of the road leased with that controlled by the receiver. It cannot be that a receiver, without an enabling statute in his behalf and without authority in the corporation he represents, can, by mere order of court, assume the discharge of public duties imposed on another corporation.

Ct. Rep. 1011). Whether a debt for rental of a leased line, part of a railroad system, shall be treated as an obligation of the receivership, see *Central R., etc. Co. v. Farmers Loan, etc. Co.*, 79 Fed. 158 (1897).

Lessor has no preferred claim for rentals during receivership where it did not demand either possession or confirmation of lease by receiver. *New York, etc. R. Co. v. New York, etc. R. Co.*, 58 Fed. 268 (1893).

<sup>1</sup> *Central Trust Co. v. Wabash, etc. R. Co.*, 38 Fed. 63 (1889).

<sup>2</sup> *Central Trust Co. v. Wabash, etc. R. Co.*, 50 Fed. 857 (1892).

<sup>3</sup> *State v. McMinnville, etc. R. Co.*, 6 Lea (Tenn.), 369 (1880); *McMinnville, etc. R. Co. v. Huggins, 3 Baxt. (Tenn.)* 177 (1873).

<sup>4</sup> *Gibert v. Washington City, etc. R. Co.*, 33 Gratt. (Va.) 586 (1880); *Mercantile Trust Co. v. Missouri, etc. R. Co.*, 41 Fed. 8 (1889).

## CHAPTER XXII

## ULTRA VIRES AND VOIDABLE RAILROAD LEASES

- § 239. Distinction between *Ultra Vires* and Irregular Leases.
- § 240. Enforcement of Executory *Ultra Vires* Leases.
- § 241. Delivery of Possession under *Ultra Vires* Lease.
- § 242. Right and Duty of Disaffirmance.
- § 243. Recovery of Property after Disaffirmance.
- § 244. Recovery on *Quantum meruit* for Past Use.
- § 245. Improvements made by Lessee under *Ultra Vires* Lease.
- § 246. Effect of *Ultra Vires* Lease upon Stock Subscriptions.
- § 247. Guarantee of *Ultra Vires* Lease Void.
- § 248. Voidable Railroad Leases.
- § 249. Leases of Railroads for Purpose of suppressing Competition.
- § 250. Remedy of State — *Quo Warranto*.
- § 251. Remedy of State — Injunction.

§ 239. Distinction between *Ultra Vires* and Irregular Leases.

— There is an obvious distinction between a want of power and a want of formalities in the exercise of power. More precisely, the exercise by a corporation of a power not conferred by its charter or the laws of its incorporation, is clearly distinguishable from the irregular exercise, in a particular instance, of a general power conferred upon a corporation.<sup>1</sup>

<sup>1</sup> In *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 59 (1891), (11 Sup. Ct. Rep. 478), Mr. Justice Gray said: "A contract of a corporation, which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or

be the foundation of any right of action upon it. When a corporation is acting within the general scope of the powers conferred upon it by the legislature, the corporation, as well as persons contracting with it, may be estopped to deny that it had complied with the legal formalities which are prerequisites to its existence or to its action, because such requisites might in fact have been complied with. But when the contract is beyond the powers conferred upon it by existing laws, neither the corporation, nor the other party to the contract, can be estopped, by assenting to it, or by acting upon it, to show that it was prohibited by those laws. The doctrine of the common law, by which a tenant of real estate is es-

A lease of a railroad, without legislative authority, is wholly void, and the parties thereto are permitted to plead their want of authority, upon the ground that a court will not interfere in aid of parties to an illegal enterprise. Principles of estoppel and ratification are inapplicable. A corporation cannot ratify that which it was without power to do in the first instance; and it cannot be estopped from pleading *ultra vires*, because all persons having dealings with it are bound to take notice of the limitations of its charter.<sup>1</sup> If, however,

topped to deny his landlord's title, has never been considered by this court as applicable to leases by railroad corporations of their roads and franchises. It certainly has no bearing upon the question whether this defendant may set up that the lease sued on, which is not of real estate, but of personal property, and which includes, as inseparable from the other property transferred, the inalienable franchise of the plaintiff, is unlawful and void, for want of legal capacity in the plaintiff to make it."

And in *Davis v. Old Colony R. Co.*, 131 Mass. 260 (1881), (41 Am. Rep. 221), Mr. Justice Gray, then Chief Justice of the Supreme Judicial Court of Massachusetts, said: "There is a clear distinction, as was pointed out by Mr. Justice Campbell in *Zabriskie v. Cleveland, etc. R. Co.*, 23 How. (U. S.) 398 (1859), by Mr. Justice Hoar in *Monument Bank v. Globe Works*, 101 Mass. 58 (1869) (3 Am. Rep. 322), and by Lord Chancellor Cairns and Lord Hatherly in *Ashbury Carriage, etc. Co. v. Riche*, L. R. 7 H. L. 684 (1875), between the exercise by a corporation of a power not conferred upon it, varying from the objects of its creation as declared in the law of its organization, of which all persons dealing with it are bound to take notice; and the abuse of a general power, or the failure to comply with prescribed formalities or regulations, in a particular instance, when such abuse or

failure is not known to the other contracting party."

See also *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543 (1869), (99 Am. Dec. 300); *City Fire, etc. Ins. Co. v. Carugi*, 41 Ga. 660 (1871); *Royal British Bank v. Turquand*, 6 El. & Bl. 327 (1856).

<sup>1</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 163 U. S. 581 (1896), (16 Sup. Ct. Rep. 1173): "The general rule is that a contract by which a railroad company renders itself incapable of performing its duties to the public, or attempts to absolve itself from those obligations without the consent of the State, or a contract made by a corporation beyond the scope of its powers, express or implied, on a proper construction of its charter, cannot be enforced, or rendered enforceable by the application of the doctrine of estoppel; . . . but where the subject-matter of the contract is not foreign to the purposes for which the corporation is created, a contract embracing 'whatever may fairly be regarded as incidental to, or consequential upon, those things which the legislature has authorized, ought not, unless expressly prohibited, to be held by judicial construction to be *ultra vires*.'"

A legislative act purporting to ratify an *ultra vires* lease, is, in effect, a new grant of power. The acceptance of rent under an *ultra vires* lease does not make it valid. *Ogdensburgh, etc. R. Co. v. Vermont, etc. R. Co.*, 4 Hun (N. Y.), 268 (1875).

the execution of the lease is within the powers of the contracting corporations, but either has failed to conform to statutory regulations designed for the protection of its stockholders, the stockholders may ratify the lease and, as already shown, both the corporation and the stockholders may be estopped from denying its validity.<sup>1</sup>

§ 240. **Enforcement of Executory Ultra Vires Leases.** — While executed contracts made by corporations in excess of their legal powers have, in some jurisdictions, been upheld by the courts, and parties have been precluded from setting up as a defence to actions brought by or against corporations their want of power to enter into such contracts, the doctrine has never been applied to mere executory contracts.<sup>2</sup>

Public policy forbids *ultra vires* leases of railroads, and the authorities are practically unanimous in holding that in no way, directly or indirectly, will the courts allow an action to be maintained to enforce the provisions of such leases, while they remain executory.<sup>3</sup> They will not aid a corporation to

<sup>1</sup> Boston, etc. R. Co. v. New York, etc. R. Co., 13 R. I. 260 (1881); Humphreys v. St. Louis, etc. R. Co., 37 Fed. 307 (1889). See also *ante*, § 192: "Acquiescence and Laches of Stockholders"; *ante*, § 196: "Corporation may be estopped from alleging Irregular Execution of Lease."

<sup>2</sup> *United States*: Safety Insulated Wire, etc. Co. v. Baltimore, 74 Fed. 135 (1890).

*Massachusetts*: In *White v. Buss*, 3 Cush. 449 (1849), Chief Justice Shaw laid down the rule as follows: "It is well settled by the authorities, that any promise, contract or undertaking, the performance of which would tend to promote, advance, or carry into effect an object or purpose which is unlawful, is in itself void and will not maintain an action."

*New York*: *Nassau Bank v. Jones*, 95 N. Y. 122 (1882), (47 Am. Rep. 14). Also *Jemison v. Citizens Savings Bank*, 122 N. Y. 142 (1890), (25 N. E. Rep. 264), 19 Am. St. Rep. 482; *Tracy v. Talmadge*, 14 N. Y. 162 (1856).

*England*: *Ashbury Railway Carriage, etc. Co. v. Riche*, L. R. 7 H. L. 653 (1875), L. R. 9 Ex. 224; *Caledonian, etc. R. Co. v. Magistrates of Helensburgh*, 2 Macq. 391 (1855).

<sup>3</sup> *United States*: *Pullman Car Co. v. Central Transp. Co.*, 171 U. S. 138 (1898), (18 Sup. Ct. Rep. 808); *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953); *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409); *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094); *Thomas v. Railroad Co.*, 101 U. S. 71 (1879).

*Maine*: *Brunswick Gas Light Co. v. United Gas, etc. Co.*, 85 Me. 532 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 385).

*New York*: *Compare Bath Gas Light Co. v. Claffy*, 151 N. Y. 24 (1896), (45 N. E. Rep. 390, 36 L. R. A.



enforce its unlawful contracts. They will not assist in diverting corporate funds to unauthorized objects, to the detriment of stockholders and creditors and prejudice of the rights of the State. While the application of this principle may allow a corporation to repudiate its contracts and escape its obligations, such result is incidental, and must be borne by the suffering party as a penalty for participating in an illegal enterprise.

Lord Mansfield thus tersely stated the position of the courts in *Holman v. Johnson*,<sup>1</sup> decided in 1775: "The objection that a contract is immoral or illegal as between the plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but is founded on general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may say so. The principle of public policy is this: *ex dolo malo non oritur actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act."

§ 241. **Delivery of Possession under Ultra Vires Lease.** — It has been held that the principle enunciated by many courts that a party to an *ultra vires* contract who has received the benefit of its full performance is estopped from questioning its validity, is applicable in the case of an unauthorized lease of a railroad where possession has passed, upon the ground that delivery of possession constitutes complete execution on the part of the lessor.<sup>2</sup> The weight of authority, however,

664); *Woodruff v. Erie R. Co.*, 93 N. Y. 609 (1883).

*England*: *East Anglian R. Co. v. Eastern Counties R. Co.*, 11 C. B. 775 (1851); *McGregor v. Dover, etc. R. Co.*, 18 Q. B. 618 (1852).

<sup>1</sup> *Holman v. Johnson*, 1 Cowp. 341 (1775).

Lord Mansfield, in *Smith v. Bromley*, 2 Doug. 696 (1760), an earlier case, says: "If the act is in itself immoral, or a violation of the general laws of public policy, then the party paying shall not have his action."

<sup>2</sup> *Camden, etc. R. Co. v. May's Landing, etc. R. Co.*, 48 N. J. L. 530 (1886), (7 Atl. Rep. 523). In this case (two judges dissenting), the Court allowed a recovery of rent accruing after an abandonment of an *ultra vires* lease, reaching the conclusion that the transaction was completed upon the part of the lessor by the delivery of the leased road, and that the other party should not be allowed to plead *ultra vires* when sued for not performing its part of the contract. The Court, however, said

supports the view that a lease is a *continuing* contract, as to rent and as to occupancy, and is *executory* in respect of its future performance.<sup>1</sup> Upon the principles just considered,

that the question is different where the State accuses a corporation of exceeding its powers, thus apparently adopting the doctrine, sometimes stated by courts, that the State alone can question *ultra vires* acts of corporations. This doctrine, however, while reasonable in many respects, is opposed to the great weight of authority.

<sup>1</sup> In *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 316 (1886), (6 Sup. Ct. Rep. 1094), Mr. Justice Miller said: "It is argued in support of the decree, that, though the contract of the lease was void, so that no action could originally have been sustained upon it, there has been for ten years such performance of it, in the use, possession and control of plaintiff's road and its franchises by the defendant, that they cannot now be permitted to repudiate or abandon it; that it now presents a class of cases which hold that where a void contract has been so far executed that property has passed under it and rights have been acquired under it, the courts will not disturb the possession of such property. . . . We know of no well-considered case where a corporation, which is a party to a *continuing contract*, which it had no power to make, seeks to retract and refuses to proceed further can be compelled to do so."

And in *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 37 (1889), (9 Sup. Ct. Rep. 409), Mr. Justice Miller said: "To say that a contract which runs for ninety-six years, and which requires of both parties to it continual and actual operations and performance under it, becomes an executed contract by such performance for less than three years of the term, is carrying the doctrine much farther than it has ever been carried,

and is, decidedly, a misnomer. This class of cases is not governed by the doctrine of part performance in a suit in equity for specific performance, nor is this a suit for specific performance. This is an action at law to recover money under a contract which is void, where for nearly three years the parties acted under it, but in which one of them refuses longer to be bound by its provisions; and the argument now set up is that because the defendant has paid for all the actual use it made of the road, while engaged in the actual performance of the contract between the dates just given, it is thereby bound for more than ninety-three years longer by the contract which was made without lawful authority by its president and board of directors. We consider this proposition as needing no further consideration."

So in *Thomas v. Railroad Co.* 101 U. S. 86 (1879), the Court said: "But what is sought in the case before us is the enforcement of the unexecuted part of this agreement. So far as it has been executed, namely, the four or five years of action under it, the accounts have been adjusted, and each party has received what he was entitled to by its terms. There remains unperformed the covenant to arbitrate with regard to the value of the contract. It is the damages provided for in that clause of the contract that are sued for in this action. Damages for a material part of the contract never performed; damages for the value of a contract which was void. It is not a case of a contract fully executed. The very nature of the suit is to recover damages for its non-performance. As to this it is not an executed contract."

See also *Central Transp. Co. v.*

therefore, no action can be maintained upon such a lease for any failure to further perform it, and the lessee may surrender an unexpired term without liability for damages.

§ 242. **Right and Duty of Disaffirmance.** — As an *ultra vires* lease of a railroad is forbidden by considerations of public policy, and involves a continuing violation of the obligations of the corporations to the State, it is the duty, as well as the right, of the parties to rescind and abandon it at the earliest possible moment; and this duty is a continuing one which is rendered none the less imperative by delay in its performance.<sup>1</sup>

This right — and corresponding duty — of rescission is generally spoken of in the decisions as belonging to the lessee. Upon principle, however, there should be no distinction between the right and obligation of the lessee and of the lessor. They are both parties to an unlawful contract and owe the same duty to disaffirm it. Practically, however, the right may be said to be unilateral, owing to obstacles placed by the courts in the path of the lessor in recovering his property when the lessee has not repudiated the lease. Practically, also, the duty of rescission will rest lightly upon a lessor who risks the confiscation of his property by observing it. Thus, the Supreme Court of the United States has held that the parties to an unauthorized lease are guilty of a public wrong which precludes a court of equity from entertaining a bill by a lessor for relief from the lease and for a return of the property; and has intimated that neither a court of law nor of equity would grant a lessor, under such a lease, any relief in obtaining its

Pullman Car Co., 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); *Mallory v. Hanaur Oil Works*, 86 Tenn. 598 (1888), (8 S. W. Rep. 396). Compare *Heims Brewing Co. v. Flannery*, 137 Ill. 309 (1891), (27 N. E. Rep. 286).

<sup>1</sup> A contract made by a corporation which is unlawful and void does not by being carried into execution become lawful and valid. The proper remedy of an aggrieved party is to disaffirm the contract. *Brunswick Gas Light Co. v. United States, etc. Co.*, 85 Me. 532 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 385).

See also *Pullman Car Co. v. Central Transp. Co.*, 171 U. S. 151 (1898), (18 Sup. Ct. Rep. 808): "The right of recovery must rest upon a disaffirmance of the contract." Also *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953); *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478); *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094); *Thomas v. Railroad Co.*, 101 U. S. 71 (1879).

property, so long as the lessee was satisfied.<sup>1</sup> And the Supreme Court of Texas has carried this doctrine to its logical conclusion by holding that a lessor, under an unauthorized lease, will not receive the aid of the courts in recovering its railroad, rent or a *quantum meruit*.<sup>2</sup>

This doctrine cannot be approved. The illegality of an *ultra vires* lease involves no moral turpitude, and, while a court of equity might properly decline to disturb the possession of property acquired thereunder, a court of law should always be open to a lessor corporation when it seeks to do its duty, — to abandon an illegal continuing contract and retake its property.<sup>3</sup> An action for such a purpose is not in affirmance, but in disaffirmance, of the lease, while the denial of a remedy permits the lessee to retain the property as long as it chooses and *gives effect* to an illegal lease.<sup>4</sup>

§ 243. **Recovery of Property after Disaffirmance.** — Upon the abandonment by a lessee corporation of an *ultra vires* lease, it is bound upon principles of natural justice to return the leased property to the lessor or make compensation for its

<sup>1</sup> In *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 953), Mr. Justice Gray said: "When the parties are *in pari delicto*, and the contract has been fully executed on the part of the plaintiff, by the conveyance of property, or by the payment of money, and has not been repudiated by the defendant, it is now equally well settled that neither a court of law nor a court of equity will assist the plaintiff to recover back the property conveyed or money paid under the contract." This language was used with reference to an *ultra vires* lease which the lessor desired to cancel and under which a railroad had been transferred to and operated without objection by the lessee for seventeen years. The Court denied equitable relief and used the language above stated, which is difficult to reconcile with its language in *Pullman Car Co. v. Central Transp. Co.*, 171 U. S. 138 (1898), (18 Sup. Ct.

Rep. 808), and in *Central Transp. Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478), except upon the ground that the cases are distinguished by the lessee's repudiation of the lease in the latter cases. This, in effect, gives the lessee the exclusive right of repudiation, for if the lessor repudiates he is, according to the decision, without remedy.

<sup>2</sup> *Olcott v. International, etc. R. Co.* (Tex. 1894), 28 S. W. Rep. 728. See note to § 243, *post*: "*Recovery of Property after Disaffirmance*," for further consideration of this remarkable decision.

<sup>3</sup> That ejectment will lie to recover possession of a railroad, see *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 33 Fed. 440 (1888); *Railroad Co. v. Johnson*, 119 U. S. 608 (1887), (7 Sup. Ct. Rep. 339).

<sup>4</sup> *Parkersburgh v. Brown*, 106 U. S. 503 (1882), (1 Sup. Ct. Rep. 442), (case of invalid bonds): "The enforcement of such rights is not in

loss.<sup>1</sup> However much the contractual powers of corporations may be limited by their charters, there is no limitation upon their power to make restitution of property acquired under an unlawful lease; "nor, as corporations, are they exempted from the common obligation to do justice which binds individuals, for this duty rests upon all persons alike, whether natural or artificial."<sup>2</sup>

The Supreme Court of the United States, however, in a series of cases of controlling authority, holds that "in no way and through no channels, directly or indirectly, will the courts allow an action to be maintained for the recovery of property delivered under an illegal contract where, in order to maintain such recovery, it is necessary to have recourse to that contract. The right of recovery must rest upon a disaffirmance of the contract, and it is permitted only because of the desire of courts to do justice as far as possible to the party who has made payment or delivered property under a void agreement and which in justice he ought to recover."<sup>3</sup> Upon these principles, an action for the recovery of property delivered under an invalid lease cannot be maintained thereon upon its rescission, but will lie upon the *implied* contract of the lessee to return, or, failing in that, to make compensation for the property which it has no right to retain.<sup>4</sup> An action at law should also

affirmance of the illegal contract, but is in disaffirmance of it."

<sup>1</sup> "To say that a corporation cannot sue or be sued upon an *ultra vires* arrangement is one thing. To say that it may retain the proceeds thereof which have come into its possession without making any compensation whatever to the person from whom it has obtained them, is something very different, and savors very much of an inducement to fraud." Green's *Brice's Ultra Vires* (2d Am. Ed.), 721.

*Davis v. Old Colony R. Co.*, 131 Mass. 275 (1881), (41 Am. Rep. 221), (*per* Gray, C. J.): "A corporation may indeed be bound to refund to a person, from whom it has received money or property for a purpose unauthorized by its charter, the value

of that which it has actually received; for, in such a case, to maintain the action against the corporation is not to affirm, but to disaffirm, the illegal contract." Citing *White v. Franklin Bank*, 22 Pick. (Mass.) 181 (1839); *Morville v. American Tract Soc.*, 123 Mass. 129 (1877), (25 Am. Rep. 40); *In re Cork, etc. R. Co.*, L. R. 4 Ch. App. 748 (1869).

<sup>2</sup> *Manchester, etc. R. Co. v. Concord, etc. R. Co.*, 66 N. H. 127 (1890), (20 Atl. Rep. 384, 49 Am. St. Rep. 582, 9 L. R. A. 689).

<sup>3</sup> *Pullman Car Co. v. Central Transp. Co.*, 171 U. S. 151 (1898), (18 Sup. Ct. Rep. 808), (*per* Peckham, J.). See also cases cited in note following.

<sup>4</sup> *Central Transp. Co. v. Pullman*

be available for the recovery of the specific property, as well as a suit in equity for an accounting and restitution.<sup>1</sup>

§ 244. **Recovery on Quantum Meruit for Past Use.** — Upon the principle, just considered, that no action can be maintained upon an unlawful contract, it is held by the Supreme Court of the United States and other courts that no recovery can be had of rent, as such, due under an *ultra vires* lease, although the lessee before disaffirmance has enjoyed posses-

Car Co., 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478). See also *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*, 118 U. S. 317 (1886), (6 Sup. Ct. Rep. 1094); *Brunswick Gas Light Co. v. United Gas, etc. Co.*, 85 Me. 532 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 389).

In *Railway Companies v. Keokuk Bridge Co.*, 131 U. S. 389 (1889), (9 Sup. Ct. Rep. 770), Justice Gray said: "According to many recent opinions of this court, a contract made by a corporation, which is unlawful and void because beyond the scope of its corporate powers, does not, by being carried into execution, become lawful and valid, but the proper remedy of the party aggrieved is by disaffirming the contract, and suing to recover, as on a *quantum meruit*, the value of what the defendant has actually received the benefit of." Citing *Louisiana v. Wood*, 102 U. S. 294 (1880); *Parkersburgh v. Brown*, 106 U. S. 487 (1882), (1 Sup. Ct. Rep. 442); *Chapman v. Douglas County*, 107 U. S. 348 (1882), (2 Sup. Ct. Rep. 62); *Salt Lake City v. Hollister*, 118 U. S. 256 (1886), (6 Sup. Ct. Rep. 1055).

Compare, however, *Olcott v. International, etc. R. Co.* (Tex. 1894), 28 S. W. Rep. 728, which holds that a lessor, party to an *ultra vires* lease, will not receive the aid of the courts to obtain either the return of the property, rent or *quantum meruit* compensation; that both parties are *in pari delicto* and that the Court will leave them where they have deliberately put themselves. This

remarkable decision, permitting the absolute confiscation of the lessor's property, is the not illogical outcome of the decision of the Supreme Court of the United States in *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 145 U. S. 393 (1892), (12 Sup. Ct. Rep. 593), to which reference was made in the last section.

<sup>1</sup> A cross bill for an accounting, etc., was allowed, under the circumstances of the case, in *Pullman Car Co. v. Central Transp. Co.*, 171 U. S. 138 (1898), (18 Sup. Ct. Rep. 808), and there is no reason, in principle, why such a bill should not be allowed in all cases where the leased property has been lost or destroyed. In the celebrated case referred to, the Court, upon the principle stated in the text, decided:

(a) That the lessor was entitled to recover from the lessee the value of the property transferred to it when the lease took effect, with interest, as that property had substantially disappeared and could not be returned.

(b) That the market value of the lessor's shares was no measure of the value of the leased property, although it was its entire plant.

(c) That the lessor was not entitled to recover anything for the breaking up of its business.

For other cases as to the proper remedy, see *Louisiana v. Wood*, 102 U. S. 294 (1880); *Davis v. Old Colony R. Co.*, 131 Mass. 258 (1881), (41 Am. Rep. 221); *New Castle Northern R. Co. v. Simpson*, 23 Fed. 214 (1885).

sion of the property according to its terms.<sup>1</sup> The lessor, however, while denied a recovery of the stipulated rent, may recover compensation in an action for use and occupation based upon an implied agreement on the part of the lessee to pay the value of such use.<sup>2</sup> In such an action, on a *quantum meruit*

<sup>1</sup> Pullman Car Co. v. Central Transp. Co., 171 U. S. 138 (1898), (18 Sup. Ct. Rep. 808); Central Transp. Co. v. Pullman Car Co., 139 U. S. 60 (1891), (11 Sup. Ct. Rep. 478); Oregon R., etc. Co. v. Oregonian R. Co., 130 U. S. 1 (1899), (9 Sup. Ct. Rep. 409); Pennsylvania R. Co. v. St. Louis, etc. R. Co., 118 U. S. 290 (1886), (6 Sup. Ct. Rep. 1094); Cox v. Terre Haute, etc. R. Co., 133 Fed. 371 (1904); Brunswick Gas Light Co. v. United Gas, etc. Co., 85 Me. 532 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 389). See also Union Bridge Co. v. Troy, etc. R. Co., 7 Lans. (N. Y.) 240 (1872), although this case is not in accordance with later New York authorities.

In Olcott v. International, etc. R. Co. (Tex. 1894), 28 S. W. Rep. 728, referred to in the last section, the Court denied a lessor compensation based either upon the lease or upon a *quantum meruit*. For reasons already pointed out, this decision is as far removed from good law as it is from just principles.

<sup>2</sup> Brunswick Gas Light Co. v. United Gas, etc. Co., 85 Me. 532 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 389); Manchester, etc. R. Co. v. Concord R. Co., 66 N. H. 100 (1890), (20 Atl. Rep. 383, 49 Am. St. Rep. 582, 9 L. R. A. 689). While the Supreme Court of the United States has not decided the precise question whether a recovery can be had upon a *quantum meruit* for past use under an *ultra vires* lease, it is apparent from its language in Pullman Car Co. v. Central Transp. Co., 171 U. S. 150 (1898), (18 Sup. Ct. Rep. 808), and Central Transp. Co. v. Pullman Car

Co., 139 U. S. 60 (1891), (11 Sup. Ct. Rep. 478), that should the case come before it such recovery would be allowed. Thus in the latter case the Court said: "A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms; but on an implied contract of the defendant to return, or, failing to do that, to make compensation for property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm, the unlawful contract." Citing Pittsburgh, etc. R. Co. v. Keokuk, etc. Bridge Co., 131 U. S. 371 (1881), (9 Sup. Ct. Rep. 770); Salt Lake City v. Hollister, 118 U. S. 263 (1886), (6 Sup. Ct. Rep. 1055); Chapman v. Douglas Co., 107 U. S. 355 (1882), (2 Sup. Ct. Rep. 62); Parkersburgh v. Brown, 106 U. S. 503 (1882), (1 Sup. Ct. Rep. 442); Louisiana v. Wood, 102 U. S. 299 (1880); Hitchcock v. Galveston, 96 U. S. 350 (1887).

See also cases collected in dissenting opinion of Vann, J., in Bath Gas Light Co. v. Claffy, 151 N. Y. 45 (1896), (45 N. E. Rep. 390, 36 L. R. A. 664).

the lease may be introduced in evidence as in the nature of an admission of what is a reasonable rental, but it is held that it cannot govern or control the amount to be allowed.<sup>1</sup>

On the other hand, it is held by other courts, under the leadership of the New York Court of Appeals, upon principles of estoppel, that the lessee is bound by the terms of the lease for the time he remains in possession, and that recovery of past due rent may be obtained by the lessor, *in an action on the lease*, although it may be void as to the public.<sup>2</sup> As said by Chief Judge Andrews in *Bath Gas Light Co. v. Claffy*:<sup>3</sup> "The State has not intervened, and the possession of the property has now been restored to its original proprietors. The contract has been terminated as to the future, and all that remains undone is the payment by the lessee of the unpaid rent. We think the demands of public policy are fully satisfied by holding that, as to the public, the lease was void, but that, as between the parties, so long as the occupation under the lease continued, the lessee was bound to pay the rent, and that its recovery may be enforced by action on the covenant. Public policy is promoted by the discouragement of fraud, and the maintenance of the obligations of contracts, and to permit a lessee of a corporation to escape the payment of rent by pleading the incapacity of the corporation to make the lease, although he has had the undisturbed enjoyment of the property, would be, we think, most inequitable and unjust. . . . We think the rule which should be applied is that the lessee is bound by the contract so long as he remains in possession."

<sup>1</sup> *Brunswick Gas Light Co. v. United Gas, etc. Co.*, 85 Me. 532 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 389).

<sup>2</sup> *Bath Gas Light Co. v. Claffy*, 151 N. Y. 24 (1896), (45 N. E. Rep. 390, 36 L. R. A. 664); *Woodruff v. Erie R. Co.*, 93 N. Y. 609 (1883); *Camden, etc. R. Co. v. May's Landing, etc. R. Co.*, 48 N. J. L. 530 (1886), (7 Atl. Rep. 523).

<sup>3</sup> *Bath Gas Light Co. v. Claffy*, 151 N. Y. 34 (1896), (45 N. E. Rep. 390, 36 L. R. A. 664). In his opinion in

this case, Chief Judge Andrews also declared that the decisions of the Supreme Court of the United States, already referred to, carry the doctrine of *ultra vires* to an unjust extent, "and the rank injustice which, as it seems to us, these cases sanction, justifies the observation of Lord St. Leonards in the case of *Eastern Counties R. Co. v. Hawkes*, 5 H. L. Cas. 370 (1855), that 'the safety of men in their daily contracts requires that the doctrine of *ultra vires* should be confined within narrow limits.'"



Notwithstanding this reasoning it seems to follow as a necessary conclusion from the premise that an *ultra vires* lease is void that no action of any kind can be maintained upon it, and that no principles of estoppel can give it vitality. To hold that an *ultra vires* lease is void, and, at the same time, that it governs the rights of the parties in the matter of rent; that it is valid as to the past and void as to the future, is illogical, and gives a controlling effect to a void contract. "A void instrument governs nothing."<sup>1</sup> Nor is it necessary to adopt the New York rule in order to do justice to the parties. If the lessee pays, and the lessor receives, what the use of the property is reasonably worth, the result is equitable, although the one or the other may lose the benefit of the stipulations of an illegal contract.

§ 245. **Improvements made by Lessee under Ultra Vires Lease.** — As a general rule, a lessee corporation cannot recover from the lessor for improvements made upon the leased property during its occupancy under an unauthorized lease.<sup>2</sup> This rule necessarily applies in every case where an action for such recovery must be based upon the illegal contract. It is clear, however, upon the principle stated by the Supreme Court of the United States that "a contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, *have always striven to do justice between the parties*,"<sup>3</sup> that exceptions to the rule may be established where it is not necessary to rely upon the lease. Thus,

<sup>1</sup> Brunswick Gas Light Co. v. United Gas, etc. Co., 85 Me. 541 (1893), (27 Atl. Rep. 525, 35 Am. St. Rep. 389).

<sup>2</sup> In Middlesex, etc. R. Co. v. Boston, etc. R. Co., 115 Mass. 347 (1874), (7 Am. Ry. Rep. 469), it was held that a lessee under an *ultra vires* lease could not recover from the lessor expenses of renewing the road.

See also East Tennessee, etc. R. Co. v. Nashville, etc. R. Co. (Tenn. 1897), (51 S. W. Rep. 202).

State v. McMinnville, etc. R. Co.,

6 Lea (Tenn.), 369 (1880), (4 Am. & Eng. R. Cas. 95), was the case of a lease by a receiver without authority, and, under the circumstances stated in the opinion, the Court was justified in saying (p. 379): "The tenant voluntarily takes his chances of being permitted to enjoy the expenditures he has made upon the land of another."

<sup>3</sup> Central Transp. Co. v. Pullman Car Co., 139 U. S. 60 (1891), (11 Sup. Ct. Rep. 478).

where improvements of a permanent nature have been made by a lessee with the approval of the lessor, who then terminates the lease on account of its *ultra vires* character, the courts would undoubtedly allow the lessee to set off against the lessor's demand for compensation for the use of the property, compensation for improvements made upon it.

§ 246. **Effect of Ultra Vires Lease upon Stock Subscriptions.** — If a railroad company has power to lease its railroad, subscriptions to its capital stock must be regarded as having been made in view of the possible exercise of the power. If a lease is unauthorized it is void and without effect upon contracts of subscription. In neither case — under authorized or-unauthorized lease — is a subscriber discharged upon his obligation to pay calls and fulfil his contract.<sup>1</sup>

The conclusion that an *ultra vires* lease, being void, has no effect upon stock subscriptions is, obviously, logical. It is in marked contrast to the conclusion reached in the decisions examined in an earlier part of this treatise that an unauthorized consolidation, although wholly void, discharges subscribers.<sup>2</sup>

§ 247. **Guarantee of Ultra Vires Lease void.** — Where the contracting corporations to a lease of a railroad are without authority to enter into it, an agreement by another corporation guaranteeing its performance, it is equally without authority. A guarantee of a void contract is itself void. A contract to fulfil for another corporation obligations which it has no power to assume is of no legal effect.<sup>3</sup>

<sup>1</sup> *Ottawa, etc. R. Co. v. Black*, 79 Ill. 268 (1875): "If the company had no power to lease the road and its franchises, then the lease is void, and the appellees can, when they receive their stock, apply to a court of equity, and have the lease cancelled. If, on the other hand, the charter empowers the company to make such a lease, then appellees must have known the fact when they subscribed, and the exercise of a power granted by the charter must be presumed to have been contemplated by the appellees when they gave their note."

See also *Hayes v. Ottawa, etc. R. Co.*, 61 Ill. 424 (1871); *Troy, etc. R. Co. v. Kerr*, 17 Barb. (N. Y.) 581 (1854).

<sup>2</sup> See *ante*, § 47: "*Rights and Remedies of Dissenting Subscribers.*"

<sup>3</sup> *Pennsylvania R. Co. v. St. Louis, etc. R. Co.*, 118 U. S. 290 (1885), (6 Sup. Ct. Rep. 1094); *Coleman v. Eastern Counties R. Co.*, 10 Beav. 1 (1846); *Madison, etc. Plank Road Co. v. Watertown, etc. Plank Road Co.*, 7 Wis. 59 (1858).

See also *Pearce v. Madison, etc. R. Co.*, 21 How. (U. S.) 441 (1858).

In *Pennsylvania Co. v. St. Louis, etc. R. Co.*, Mr. Justice Miller said:<sup>1</sup> "There is no power shown in any of these companies to accept a lease of the complainant such as the one in the present case, and perform its conditions, and they cannot, therefore, become parties to such a contract with a road outside the State which chartered them any more than the principal company. If these guaranteeing companies had executed the original contract of lease it would have been void for want of authority from the legislature of Indiana, or of any other State by whose laws they are incorporated or endowed with corporate power. No such power is shown in them to lease roads beyond their own States. Indeed, while there may be a just claim of authority for some kind of running arrangement between two connecting roads under the Indiana statutes, there is no connection between the plaintiff's road and any road of a guaranteeing company. The connection, even by traffic, is remote. These companies might as well have assumed the power to loan them money, or to indorse their notes, or any other commercial transaction, as to guarantee the performance of a void contract by one company to another."

§ 248. **Voidable Railroad Leases.** — Officers of a railroad company stand in a fiduciary relation to the corporation. They cannot, themselves, take a lease of its property nor lease property to it.<sup>2</sup> They cannot, as directors of one corporation,

<sup>1</sup> *Pennsylvania Co. v. St. Louis, etc. R. Co.*, 118 U. S. 314 (1885), (6 Sup. Ct. Rep. 1094).

<sup>2</sup> In *Wardell v. Railroad Co.*, 103 U. S. 658 (1880), the Supreme Court of the United States laid down the following general principles relating to the obligations of officers of corporations: "It is among the rudiments of the law that the same person cannot act for himself, and at the same time, with respect to the same matter, as the agent of another whose interests are conflicting. . . The law, therefore, will always condemn the transactions of a party on his own behalf, where, in respect to the matter concerned, he is the agent of others, and

will relieve against them whenever their enforcement is reasonably resisted. Directors of corporations, and all persons who stand in a fiduciary relation to other parties, and are clothed with power to act for them, are subject to this rule. They are not permitted to occupy a position which will conflict with the interests of the parties they represent and are bound to protect. They cannot, as agents or trustees, enter into or authorize contracts on behalf of others for whom they are appointed to act, and then personally participate in the benefits. Hence all arrangements by directors of a railroad company to secure an undue advantage to themselves at its

lease its railroad to another corporation to which they stand in similar relation. The rule is based upon considerations of public policy and works independently of fraud or good intention. Any such lease is voidable at the option of either corporation.<sup>1</sup> It is not void, and may become valid by acquiescence.<sup>2</sup>

The majority of the stockholders of a railroad company, in controlling its affairs, stand in a similar position of trust towards the minority stockholders.<sup>3</sup> They cannot authorize the officers of the corporation to lease its railroad to another corporation, owned or controlled by them, unless they act with the utmost

expense by the formation of a new company as auxiliary to the original one, with an understanding that they, or some of them, shall take stock in it, and then that valuable contracts shall be given to it, in the profits of which they, as stockholders in the new company are to share, are so many unlawful devices to enrich themselves to the detriment of the stockholders and creditors of the original company, and will be condemned whenever properly brought before the court for consideration."

<sup>1</sup> *Barr v. New York, etc. R. Co.*, 125 N. Y. 263 (1891), (26 N. E. Rep. 145); *Jessup v. Illinois Central R. Co.*, 43 Fed. 483 (1890); *Meeke v. Winthrop Iron Co.*, 17 Fed. 48 (1883). See also *ante*, § 168: "*Voidable Leases.*" Also *ante*, § 114: "*Voidable Sales.*"

A complaint in a stockholder's action against a railroad corporation and its directors alleging that the latter, as officers and trustees of the defendant company, took from themselves, as trustees and officers of another company, which they practically owned and managed, a lease of its railroad to the defendant company at an exorbitant rent, and thereby depleted the latter's funds, states a good cause of action.

*Sage v. Culver*, 147 N. Y. 241 (1895), (41 N. E. Rep. 513).

Stockholders cannot sue for the

profits arising from a lease of a railroad to their corporation, in which the directors wrongfully participated, unless they also take steps to rescind the lease. *Hitchcock v. Barrett*, 50 Fed. 653 (1892).

<sup>2</sup> *Barr v. New York, etc. R. Co.*, 125 N. Y. 263 (1891), (26 N. E. Rep. 145); *Jessup v. Illinois Central R. Co.*, 43 Fed. 483 (1890).

In *Continental Ins. Co. v. New York, etc. R. Co.*, 187 N. Y. 225, 238 (1907), (79 N. E. Rep. 1026), the Court said with respect to an agreement settling a controversy arising under a railroad lease: "Assuming that the fact that the majority of the directors of the Harlem were also directors of the Central rendered the agreement made by the two boards for an apportionment of the interest reduction between the two companies voidable at the election of the Harlem stockholders, as doubtless was the case, nevertheless the agreement was not absolutely void, but could be ratified by the action of such stockholders, in which case it would become binding upon the company. The right, however, to avoid a contract made by common directors is in the corporation, not in minority stockholders."

<sup>3</sup> See *post*, § 300: "*Trust Relation of Controlling Corporation to Minority Stockholders.*"

good faith towards the whole body of stockholders. Courts of equity will protect the interests of minority stockholders.<sup>1</sup>

<sup>1</sup> In *Flynn v. Brooklyn City R. Co.*, 158 N. Y. 507 (1899), (53 N. E. Rep. 520) the New York Court of Appeals said: "As a general rule courts have nothing to do with the internal management of business corporations. Whatever may lawfully be done by the directors or stockholders, acting through majorities prescribed by law, must of necessity be submitted to by the minority, for corporations can be conducted upon no other basis. All questions within the scope of the corporate powers which relate to the policy of administration, to the expediency of proposed measures, or to the consideration of contracts, provided it is not so grossly inadequate as to be evidence of fraud, are beyond the province of the courts. The minority directors or stockholders cannot come into court upon allegations of a want of judgment or lack of efficiency on the part of the majority and change the course of administration. Corporate elections furnish the only remedy for internal dissensions, as the majority must rule so long as it keeps within the powers conferred by the charter. To these general rules, however, there are some exceptions, and the most important is that founded on fraud. While courts cannot compel directors or stockholders, proceeding by the vote of a majority, to act wisely, they can compel them to act honestly, or undo their work if they act otherwise. Where a majority of the directors, or stockholders, or both, acting in bad faith, carry into effect a scheme which, even if lawful upon its face, is intended to circumvent the minority stockholders and defraud them out of their legal rights, the courts interfere and remedy the wrong. Action on the part of directors or stockholders, pursuant to a fraudulent scheme designed to in-

jure the other stockholders, will sustain an action by the corporation, or, if it refuses to act, by a stockholder in its stead for the benefit of all the injured stockholders."

*Wormser v. Metropolitan St. R. Co.*, 98 App. Div. (N. Y.) 29 (1904), (90 N. Y. Supp. 714): "Therefore, finding as we do, as matter of law, that the Metropolitan Street Railway Company had the power and capacity to make the lease, and, as matter of fact, that it was authorized by the stockholders, and that there was no fraud or wrong perpetrated upon such stockholders of the Metropolitan Street Railway Company by any persons standing in the relation to them of trustees or in any fiduciary relation, but that the acts, whether prudent or imprudent, of such persons were performed in perfect good faith, we concur with the court at Special Term that the plaintiff was not entitled to the relief demanded, and hence that the complaint was properly dismissed."

Where the directors of a street railway company, with the approval of the majority of the stockholders, leased its property for a long term of years to another corporation in which they became interested, it was held that a court of equity would not, at the suit of a minority stockholder, annul the lease, in the absence of proof of fraud or that the lease was detrimental to the interests of the lessor corporation.

*Dickinson v. Consolidated Traction Co.*, 114 Fed. 232 (1902); *affirmed*, 119 Fed. 871 (1903).

Where a lessee of a railroad was the owner of a majority of the stock of the lessor company and, with knowledge of that fact, the lease was approved by the holders of a large part of the minority stock and was not questioned

"The right of action, however, belongs to the corporation, and should be brought by it as plaintiff, but when it will not bring the suit itself, an aggrieved stockholder, after due demand and refusal, or unreasonable neglect to proceed, may bring it in his own name upon making the corporation a party defendant. Such an action is not for the benefit of the plaintiff alone, but is representative in character and for the benefit of himself and all other stockholders similarly situated."<sup>1</sup>

§ 249. **Leases of Railroads for Purpose of suppressing Competition.** — Combinations of railroad companies for the purpose of extinguishing competition are contrary to public policy. The form of combination is immaterial. That in the form of a lease is as invalid as any other.

This subject is considered at length in the concluding part of this treatise.<sup>2</sup>

§ 250. **Remedy of State — Quo Warranto.** — When a railroad company, without legislative authority, leases its railroad and franchises for an extended term to another corporation, it thereby abandons the use of its franchises, and its charter becomes subject to forfeiture in *quo warranto* proceedings.<sup>3</sup>

by any stockholder for more than twenty-seven years, it was held that such lease would not be set aside at the suit of a minority stockholder where the matters complained of did not appear to be fraudulent or clearly inconsistent with the exercise of honest judgment.

*Wolf v. Pennsylvania R. Co.*, 195 Pa. St. 91 (1900), (45 Atl. Rep. 936).

See also: *Pondir v. New York, etc. R. Co.*, 72 Hun (N. Y.), 384 (1893), (25 N. Y. Supp. 560); *Glengary Consol. Min. Co. v. Boehmer*, 28 Colo. 1 (1900), (62 Pac. Rep. 839); *McLeary v. Erie Tel. etc. Co.*, 38 Misc. (N. Y.) 3 (1902), (76 N. Y. Supp. 712). Compare *Shaw v. Davis*, 78 Md. 308 (1894), (28 Atl. Rep. 619, 23 L. R. A. 294); *Miner v. Belle Isle Ice Co.*, 93 Mich. 97 (1892), (53 N. W. Rep. 218, 17 L. R. A. 412); *Meeker v. Winthrop Iron Co.*, 17 Fed. 48 (1883).

See also *ante*, § 168: "*Voidable Leases.*"

<sup>1</sup> *Flynn v. Brooklyn City R. Co.*, 158 N. Y. 508 (1899), (53 N. E. Rep. 520).

The right to avoid an agreement settling a question concerning the terms of a lease rests in the corporation, not in minority stockholders, unless its ratification was procured by fraud or concealment, and in ignorance of the true state of facts.

*Continental Ins. Co. v. New York, etc. R. Co.*, 187 N. Y. 225 (1907), (79 N. E. Rep. 1026).

See also *Wallace v. Long Island R. Co.*, 12 Hun (N. Y.), 464 (1877).

<sup>2</sup> See *post*, Part V.. "*Combinations of Corporations.*"

<sup>3</sup> *State v. Atchison, etc. R. Co.*, 24 Neb. 143 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164); *Commissioners of Tippecanoe Co. v. Lafayette, etc. R. Co.*, 50 Ind. 85 (1875). In *East*

In *State v. Atchison, etc. R. Co.*<sup>1</sup> the Supreme Court of Nebraska said: "While a lessee in a proper case, or assignee or purchaser, will take a road burdened with the conditions, obligations and duties assumed by the original corporation, yet there can be no such transfer by lease, assignment or sale without express statutory authority, and as we find no such authority and the defendant has been guilty of mis-user and non-user of its franchises, they are subject to forfeiture."<sup>2</sup>

§ 251. **Remedy of State — Injunction.** — As already shown, the remedy of the State, in the case of *ultra vires* acts committed by a corporation, is *quo warranto*, and, in the case of private corporations, this remedy is exclusive.<sup>3</sup> Courts of equity are not open to the State for the exercise of visitatorial powers over such corporations, and injunction is not a proper remedy to restrain their unauthorized acts. Lord Cowper, in

*Line, etc. R. Co. v. State*, 75 Tex. 434 (1889), (12 S. W. Rep. 690), *quo warranto* was sustained, forfeiting the charter of the defendant railroad company because of an illegal transfer of its railroad and franchises. See also *State v. Minnesota Central R. Co.*, 36 Minn. 246 (1886), (30 N. W. Rep. 816).

In *Eel River R. Co. v. State*, 155 Ind. 433 (1900), (57 N. E. Rep. 388), it was held that the acts of a domestic railroad company in turning over all its property and franchises to a rival company under a lease in perpetuity, and in acquiescing in the destruction of a portion of its railroad in order to destroy competition, were sufficient grounds to authorize a forfeiture of its franchises.

<sup>1</sup> *State v. Atchison, etc. R. Co.*, 24 Neb. 163 (1888), (38 N. W. Rep. 43, 8 Am. St. Rep. 164). In this case, however, the Court said that forfeiture would not be enforced in the first instance, and the lease was declared void.

<sup>2</sup> Even the consent of the State to a transfer may not prevent forfeiture under certain circumstances. This

principle is illustrated in *State v. St. Paul, etc. R. Co.*, 35 Minn. 225 (1886), (28 N. W. Rep. 3): "The consent of the State may not prevent a forfeiture of the corporate franchise, where the corporation disposes of and abandons all its business and operating franchises, so that there is nothing left which it can lawfully do, and so that there can be no reason for keeping it longer in life."

<sup>3</sup> *Attorney General v. Utica Ins. Co.*, 2 Johns. Ch. 371 (1817). In this case Chancellor Kent declined to enjoin an insurance company from doing a banking business. The equitable remedy is, however, now open to the State, in New York, under the Code of Civil Procedure, in relation to the "judicial supervision" of corporations. *People v. Ballard*, 134 N. Y. 269 (1892), (32 N. E. Rep. 54). In *Attorney General v. Tudor Ice Co.*, 104 Mass. 239 (1870), (6 Am. Rep. 227), where an injunction to restrain an ice company from importing teas was refused, the cases bearing upon the rights of the State in a court of equity are collected and carefully considered.

a very early English case,<sup>1</sup> denied the attorney-general a remedy in equity against a corporate excess of powers upon the ground that "it would usurp too much on the king's bench"; and such is substantially the reason of the rule at the present time — adequate remedy at law.

This rule is also, undoubtedly, applicable, in the case of a *quasi*-public corporation, where the *ultra vires* act relates merely to the internal affairs of the corporation; but where it involves the relations of the corporation to the State and may injuriously affect the public interests, it is inapplicable, and the State may file a bill in equity and obtain an injunction restraining the exercise of the power usurped.<sup>2</sup> This remedy is especially available in the case of railroad companies, which exercise the power of eminent domain by delegation from the State; and an *ultra vires* lease of a railroad and franchises forbidden by public policy may be restrained in its execution and performance at the suit of the State. Where such a lease is not only unauthorized but is forbidden by statutory<sup>3</sup> or

<sup>1</sup> Attorney General v. Reynolds, 1 Eq. Cas. Ab. (3d Ed.) 131 (1705).

<sup>2</sup> The attorney general has the right, when the property of the sovereign, or the interests of the public are directly concerned, to institute suit for their protection, by information at law or in equity, without a relator. Attorney General v. Delaware, etc. R. Co., 36 N. J. Eq. 631 (1876).

In Attorney General v. Great Northern R. Co., 1 Dr. & Sm. 154 (1860), a railroad company was restrained from trading in coal in large quantities. See also State v. Dodge, etc. R. Co., 53 Kan. 377 (1894), (36 Pac. Rep. 747, 42 Am. St. Rep. 295); Attorney General v. Jamaica Pond Aqueduct, 133 Mass. 361 (1882); United States v. Western Union Tel. Co., 50 Fed. Rep. 28 (1892), *affirmed*, 160 U. S. 53 (1895), (16 Sup. Ct. Rep. 210); Attorney General v. Chicago, etc. R. Co., 35 Wis. 425 (1874); Buck Mountain Coal Co. v. Lehigh Coal, etc. Co., 50 Pa. St. 91 (1865), (88 Am. Dec. 534);

Attorney General v. Mid-Kent R. Co., L. R. 3 Ch. App. 100 (1867); Ware v. Regent's Canal Co., 3 De Gex & J. 212 (1858); Hare v. London, etc. R. Co., 2 Johns. & Hen. 80 (1861). Compare, however, Attorney General v. Great Eastern R. Co., L. R. 11 Ch. D. 449 (1879).

<sup>3</sup> In Stockton v. Central R. Co., 50 N. J. Eq. 52 (1892), (24 Atl. Rep. 964, 17 L. R. A. 97), the Attorney General of New Jersey filed a bill in equity to have the lease of the Central Railroad Company of New Jersey to the Port Reading Railroad Company, a small New Jersey corporation controlled by the Philadelphia and Reading Railroad Company, declared to be *ultra vires* and void, and for an injunction against taking possession thereunder. The Court held that the lease was, in effect, a lease to the Philadelphia and Reading Railroad Company — a foreign corporation; that it was not only unauthorized, but forbidden by the New Jersey statute; that its effect was to partially destroy



constitutional<sup>1</sup> provisions, or tends to the creation of a monopoly,<sup>2</sup> the inadequacy of *quo warranto* as a preventive remedy is apparent.

## CHAPTER XXIII

### LEASES TO FOREIGN CORPORATIONS

§ 252. Authority to lease must be derived from State where Railroad is located.

§ 253. Authority to lease to Foreign Corporation.

§ 254. Status of Foreign Corporation leasing Railroad.

§ 252. Authority to lease must be derived from State where Railroad is located. — The charter of a corporation granted by a State has no binding force *proprio vigore* outside its territorial limits. As said in an early case: "Every power which a corporation exercises in another State, depends for its validity upon the laws of the sovereignty in which it is exercised."<sup>3</sup>

While, by the comity between States, a foreign railroad

competition in the production of sale of anthracite coal; that it was *ultra vires*, and tended to monopoly; and granted the relief prayed for. It is of interest to note that the Central Railroad Company of New Jersey is now controlled by the Reading Railroad Company through the ownership of stock upon which it has issued collateral trust bonds — a convenient alternative to a lease.

<sup>1</sup> The State may maintain a suit to enjoin a railroad company from purchasing the property and lines of other companies, in violation of Kentucky Constitution, § 201, providing that no railroad company shall acquire, by purchase or otherwise, any parallel or competing line. *Louisville, etc. R. Co., v. Commonwealth*, 97 Ky. 675 (1895), (31 S. W. Rep. 476) (*affirmed sub nom. Louisville, etc. R. Co. v. Ken-*

*tucky*, 161 U. S. 677, (1896), (16 Sup. Ct. Rep. 714)), where the Court said (p. 695): "It is contended injunction is not the proper remedy. But it seems to us if the Commonwealth of Kentucky can sue at all for act *ultra vires* by a corporation, there is no room for disputing its right to a preventive injunction in this case. For, according to very reputable authority, and, we think, upon principle, a court of equity has jurisdiction, and may, in an action by the State, enjoin a corporation from exceeding its chartered powers, or doing acts otherwise illegal and injurious to the public."

<sup>2</sup> *Stockton v. Central R. Co.*, 50 N. J. Eq. 52 (1892), (24 Atl. Rep. 964, 17 L. R. A. 97).

<sup>3</sup> *Runyan v. Coster's Lessee*, 14 Pet. (U. S.) 122 (1840).

company may be permitted within a State to make contracts and exercise ordinary powers in the general transaction of business, such a corporation cannot lease or take a lease of a railroad without the consent of the State in which it is located.<sup>1</sup> The State, in authorizing the building of a railroad within its borders, reserves the right to control its transfer.

The rule that a railroad lease is invalid unless each corporation is authorized thereto by the State of its creation, requires the additional provision that the State in which the railroad is situated shall give its approval. Only in a case where a railroad company owns a railroad in a foreign State will the additional requirement impose an additional obligation.

This limitation upon the power of a corporation in a foreign State is not founded upon the principle of *ultra vires*. A corporation may be expressly authorized by its charter to transact business in foreign countries and States.<sup>2</sup> Its articles of association — when formed under general laws — may, in terms, authorize it to lease railroads in other States. The power so granted or assumed can be exercised only by permission of the foreign State. It is not so much a question of corporate power as of the right to exercise it.<sup>3</sup>

<sup>1</sup> *Briscoe v. Southern Kansas R. Co.*, 40 Fed. 280 (1889): "It is decided in *Bank v. Earle*, 13 Pet. 524 (1839), that courts of justice have always expounded and executed contracts according to the law of the place in which they are made, provided that the law was not repugnant to the laws or policy of their own country. The court, in the above case, held the rule to be 'that, by the comity of nations, foreign corporations are allowed to make contracts under their respective limits not contrary to the known policy of such nations, or injurious to their interests.' This gives a railroad corporation the right to exercise all its ordinary powers growing out of its franchise, such as making contracts in regard to the transaction of its business, as was the case in *Railroad Company v. Gebhard*, 109 U. S. 527 (1883), (3 Sup. Ct. Rep. 363). But when it

undertakes, by a lease of its road, to get rid of its responsibility, or liabilities to the public, which it assumed when it accepted the franchise, it would be exercising an extraordinary power, which may be greatly prejudicial to the public, and therefore is contrary to the known policy of a State, and injurious to its interests and cannot be exercised unless the State, by express authority conferred, authorizes it to be done." See also *Howard v. Chesapeake, etc. R. Co.*, 11 App. Cas. (D. C.) 300 (1897).

<sup>2</sup> An examination of broad charters granted by certain States will disclose the curious fact that corporations are often authorized to exercise most extraordinary powers, provided they do not exercise them within the limits of the State granting them.

<sup>3</sup> Where the incorporators under an English Companies' Act inserted in the

§ 253. **Authority to lease to Foreign Corporation.** — As shown in the last section, a corporation created by one State cannot take a lease of a railroad situated in another State without its permission. Many States have passed general laws granting this permission to foreign railroad companies, which have already been referred to.<sup>1</sup>

Under such statutes, a lease of a railroad may be lawfully taken by a foreign corporation provided it is, itself, acting within the powers conferred by the State of its creation. Thus, under the New York statute authorizing railroad companies "to contract with each other," it was held that a New York corporation might take a lease of a railroad in Vermont, owned and operated by a corporation of that State, where such corporation was given by its charter power to enter into such a contract.<sup>2</sup>

Upon the principle that power to lease to a foreign corporation must be clearly expressed, the Supreme Court of New Jersey held that a statute of that State authorizing a railroad and canal company to make arrangements for connection or

articles of association a power to lease railroads in foreign countries, it was held that the corporation acquired thereby no authority to lease a railroad in Oregon. Power to act in foreign countries cannot be so created by the parties themselves. *Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409), *reversing* 22 Fed. 245 (1884), and 23 Fed. 232 (1885).

<sup>1</sup> See *ante*, § 180: "*What Railroads may be leased. Statutory Provisions.*"

<sup>2</sup> *Day v. Ogdensburgh, etc. R. Co.*, 107 N. Y. 129 (1887), (13 N. E. Rep. 765): "It is next argued for the respondents that the arrangement expressed through these instruments, so far as the Ogdensburgh & Lake Champlain Railroad Company is concerned, is beyond the capacity and power of that corporation. We have seen that the Vermont Railroad Company had corporate powers, and among those expressly given by its charter is a power to lease its road.

It had, therefore, contracting capacity, and was a good party to deal with. The Ogdensburgh & Lake Champlain Railroad, on its part, lacked no power expressly given by statute to similar corporations in this State, nor any which, as incident and necessary thereto, might enable it to carry on the objects of the incorporation. . . Unless we are to . . . say that its operation must be confined to contracts with roads operating in and under the laws of this State, the lease must be held valid between the parties. We see no reason for such restriction nor any principle of public law which requires it. We are not at liberty to create it. It would be legislation, not construction. A corporation given capacity to contract, may exercise that capacity with any party in or outside the limits of the State, unless the law-making power of that other State forbids." *Compare* *Briscoe v. Southern Kan. R. Co.*, 40 Fed. 273 (1889).

consolidation of business by agreement, contract or lease "with any other railroad or canal company in this State or otherwise" did not authorize a lease to a corporation not of that State.<sup>1</sup> The Court said: "No power is given to lease to a company out of this State unless the word 'otherwise,' which is not an adverb of place, is held to mean 'otherwise.' It is an inappropriate word to express such meaning."<sup>2</sup>

A Minnesota statute providing that "any railroad corporation may lease or purchase any part or all of any railroad constructed by another corporation whose lines of road are continuous or connected with its own" has been held, in view of its title and other statutory provisions, to confer authority only for a lease between corporations of that State.<sup>3</sup>

§ 254. **Status of Foreign Corporation leasing Railroad.**—Statutes authorizing the leasing of railroads located within the State to corporations of another State often define the *status*, and prescribe the rights and duties, of the foreign lessee corporation.<sup>4</sup>

<sup>1</sup> *Black v. Delaware, etc. Canal Co.*, 24 N. J. Eq. 475 (1873). Compare *Stewart v. Lehigh Valley R. Co.*, 38 N. J. L. 505 (1875).

The New Jersey act of 1885, forbidding any lease of a railroad to a foreign corporation without the consent of the legislature, could not be evaded by a nominal lease to a domestic corporation whose stock was owned by a foreign corporation, which was the real lessee. *Stockton v. Central R. Co.*, 50 N. J. Eq. 75 (1892), (24 Atl. Rep. 964, 17 L. R. A. 97).

<sup>2</sup> Notwithstanding the reasoning of the Court, it seems entirely clear that the legislature *did* use the word "otherwise" precisely in the sense of "otherwise," and intended to include corporations within and without the State.

<sup>3</sup> *Freeman v. Minneapolis, etc. R. Co.*, 28 Minn. 443 (1881), (10 N. W. Rep. 594).

In *St. Louis, etc. R. Co. v. Terre Haute, etc. R. Co.*, 33 Fed. 440 (1888), affirmed 145 U. S. 393 (1892), (12 Sup.

Ct. Rep. 953), it was held that a lease of a railroad, executed by an Illinois railway company to an Indiana company, was invalid, because the latter company was not authorized to accept a lease from an Illinois corporation.

<sup>4</sup> The following contains the substance of several statutes relating to foreign lessee corporations:

*Arkansas.* San. & H. Dig. 1894, § 6334: A corporation of another State being a lessee of a railroad in this State, shall likewise be held liable for violation of laws of this State, and may be sued and sue in all cases, and for the same causes and in the same manner, as a corporation of this State.

*Kansas.* G. S. 1897, ch. 70, § 96: A railroad company of another State which shall lease a railroad in this State shall possess, in this State, all the rights, powers, privileges and franchises conferred by the laws of this State upon a railroad company of this State.

In the absence of express statutory provision, a corporation of another State operating a domestic railroad takes it subject to all the conditions and burdens attaching to it, and to the obligations respecting the operation of railroads imposed by the laws of the State in which it is located upon railroad companies generally.<sup>1</sup>

## CHAPTER XXIV

### TRACKAGE CONTRACTS

- § 255. Nature of a Trackage Contract.
- § 256. Express Authority not necessary for Execution of Trackage Contract.
- § 257. Execution of Trackage Contracts.
- § 258. Assignability of Trackage Contracts.
- § 259. Construction of Trackage Contracts.
- § 260. Specific Performance of Trackage Contracts.
- § 261. Liability of Proprietary Company to Third Persons.
- § 262. Liability of Licensee Company to Third Persons.
- § 263. Liability to Employees.

§ 255. **Nature of a Trackage Contract.** — A trackage contract is an agreement by which one railway company lets another company into a joint use of a portion of its tracks. It is clearly distinguishable from a lease in that it conveys no

*Michigan.* P. A. 1901, Act. No. 30, page 50: "The foreign railroad company so leasing shall operate and hold the railroad subject to all the duties and obligations and with all the rights and privileges prescribed by the general railroad law of this State."

*Missouri.* R. S. 1899, § 1060: If a railroad company of another State shall lease a railroad in this State it shall be held liable for the violation of any laws of this State, and may sue and be sued for the same causes and in the same manner as a corporation of this State.

*Nebraska.* Comp. Stat. 1901, §

1768: A railroad company of another State which shall lease a railroad in this State shall possess all rights, powers, privileges and franchises possessed by corporations of this State.

*South Dakota.* Anno. Stat. 1901, § 3906: Similar to Nebraska statute, *supra*.

*Wyoming.* R. S. 1899, § 3206: Similar to Nebraska statute, *supra*. Also confers the right of eminent domain.

<sup>1</sup> *McCandless v. Richmond, etc. R. Co.*, 38 S. C. 103 (1892), (16 S. E. Rep. 429, 18 L. R. A. 440).

estate in the property and no right to its exclusive possession.<sup>1</sup> It is in the nature of a license — although non-revocable and enforceable — or a grant of a privilege for hire.<sup>2</sup>

Trackage contracts may be made upon any basis the contracting corporations determine. Contracts upon a "wheelage" or "mileage" basis are common.

In England, the right of a railway company to work its traffic over a portion of the line of another company does not, as a general rule, depend upon the ability of the two corporations to agree upon a contract. Many railway acts grant the right to one company to exercise "running powers" — as they are designated — over the tracks of another and provide

<sup>1</sup> Union Pacific R. Co. v. Chicago, etc. R. Co., 163 U. S. 583 (1895), (16 Sup. Ct. Rep. 1173): "The contract in this regard was really an agreement for trackage rights, for running arrangements, a 'terminal contract' with compensation upon a 'mileage' or 'wheelage' basis . . . (p. 593) The stipulations of the contract relating to the use of the Rock Island tracks between South Omaha and Lincoln by the Pacific Company did not embrace the acquisition of right of way or real estate."

A statutory right in one corporation to use the land of another company for the purpose of making connections has, however, been held to be an "interest in lands" within the provision of the Statute of Frauds. Port Jervis, etc. R. Co. v. New York, etc. R. Co., 132 N. Y. 445 (1892), (30 N. E. Rep. 855).

A railroad company owning a railroad between two points entered into an agreement with another company called a *lease* by which the latter company was given the right to use the tracks between such points, the agreement providing that "said railroad shall be operated by the parties hereto jointly." It was held that the agreement was merely a grant of trackage rights and not a merging of the business of the two companies.

Central Trust Co. v. Colo. Midland R. Co., 89 Fed. 560 (1898).

An agreement by which one railroad company obtains trackage rights over the road of another and a joint use of terminals, yards and other facilities, and by which a third company obtains also the joint use of such yard and facilities and which is of benefit to the public in facilitating the transportation of freight, is valid.

Georgia R., etc. Co. v. Maddox, 116 Ga. 64 (1902), (42 S. E. Rep. 315).

<sup>2</sup> In Coney Island, etc. R. Co. v. Brooklyn Cable Co., 53 Hun (N. Y.), 170 (1889), (6 N. Y. Supp. 108), the Court said: "The contract here is a mere license or privilege for hire. It is not a lease conveying an interest in the realty but an agreement containing mutual stipulations in the nature of a license. It is clear the intent was to permit the first licensee to run its cars over the tracks mentioned. Had it been designed to cover any more than such a privilege other terms would have been used to indicate such an intention."

See also Richmond, etc. R. Co. v. Durham, etc. R. Co., 104 N. C. 658 (1889), (40 Am. & Eng. R. Cas. 488, 10 S. E. Rep. 659).

that in case of disagreement as to the compensation to be paid the matter shall be submitted to arbitration.<sup>1</sup>

Similar statutes compelling railroad companies to furnish facilities to intersecting roads for the purpose of making track connections, and providing for the ascertainment of compensation therefor, have been enacted in many American States.<sup>2</sup>

§ 256. **Express Authority not necessary for Execution of Trackage Contract.**—Express statutory authority is not necessary to enable a railroad company to enter into a trackage contract granting to another company, in common with itself, the right to use a portion of its tracks and facilities, not required for the exercise of its own franchises. The rule that a railroad company cannot, without legislative authority, alienate its franchises or property necessary for the discharge of its duties to the public, has no application. The owner of the railroad under such a contract transfers no franchise, parts with no property and is not excluded from the use and

<sup>1</sup> For general statute see Railway Clauses Act of 1845, § 92.

Where an act provided that the running powers granted were to be exercised upon *terms* to be agreed upon, or in default of agreement to be settled by arbitration, and the owners of the railway were to make all arrangements required by the agreement or arbitration, it was held that "terms" included the necessary arrangements for regulating the joint traffic. *Swansea, etc. R. Co. v. Swansea, etc. R. Co.*, 3 Ry. & C. T. Cases, 339 (1879).

Where an act gave a railway company running powers over part of the line of another company for "local traffic" it was held that that phrase meant "traffic from one known station to another on the line." *Midland R. Co. v. Manchester, etc. R. Co.*, 22 L. T. Rep. 601 (1870). See also *Plymouth, etc. R. Co. v. Great Western R. Co.*, 6 Ry. & C. T. Cases, 101 (1889).

For other cases construing acts of

Parliament granting running powers and providing for the ascertainment of compensation see *Midland R. Co. v. Neath, etc. R. Co.*, 2 Ry. & C. T. Cases, 366 (1876); *Caledonia R. Co. v. North British R. Co.*, 2 Ry. & C. T. Cases, 271 (1875); *Taff Vale R. Co. v. Ryhmney R. Co.*, 2 Ry. & C. T. Cases, 176 (1875); *South Devon R. Co. v. Devon, etc. R. Co.*, 2 Ry. & C. T. Cases, 348 (1876).

<sup>2</sup> See *New York* statute construed in *Port Jervis, etc. R. Co. v. New York, etc. R. Co.*, 132 N. Y. 439 (1892), (30 N. E. Rep. 855). Also *Pennsylvania* statute construed in *Altoona, etc. R. Co. v. Beech Creek R. Co.*, 177 Pa. St. 443 (1896), (35 Atl. Rep. 734).

An *Ohio* statute authorizing railroad companies to make "running arrangements" with other companies is construed in *Stanley v. Cleveland, etc. R. Co.*, 18 Ohio St. 552 (1869).

For charter provision see *Olcott v. Tioga R. Co.*, 27 N. Y. 546 (1863), (84 Am. Dec. 298).

enjoyment of its property and franchises. It merely grants the surplus use of its tracks.<sup>1</sup>

In *Union Pacific R. Co. v. Chicago, etc. R. Co.*<sup>2</sup> the Supreme Court of the United States said: "By the contract the Pacific Company parted with no franchise, and was not excluded from any part of its property or the full enjoyment of it. What it agreed to do was to let the Rock Island into such use of the bridge and tracks as it did not need for its own purposes. This did not alien any property or right necessary to the discharge of its public obligations and duties, but simply widened the extent of the use of its property for the same purposes for which that property was acquired, to its own profit so far as that use was concerned, and in the furtherance of the demands of a wise public policy. If, by so doing, it may have assisted a competitor, it does not lie in its mouth to urge that as rendering its contract illegal as opposed to public policy. Ability to perform its own immediate duties to the public is the limitation on its *jus disponendi* we are considering, and that limitation had no application to such a use as that in question."

One railroad company, however, has no implied power to grant to another company such extensive running privileges as to amount, practically, to turning over to the latter the control of its road.<sup>3</sup>

<sup>1</sup> See *ante*, § 172: "*Leases of Surplus Property.*"

<sup>2</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 163 U. S. 589 (1896), (16 Sup. Ct. Rep. 1173), *per* Fuller, C. J., *affirming* 51 Fed. 309 (1892).

<sup>3</sup> "Corporations may make all necessary arrangements for cheaply and expeditiously developing or carrying on their particular business; but it is another thing, going beyond this, to enter into contracts, for instance, by which the exclusive control or the exclusive right of working the line is handed over to other parties. All such arrangements, whatever their form, however disguised, are *ultra vires* and void." Green's *Brice's Ultra Vires* 427. See also *Earle v. Seattle, etc. R. Co.*,

46 Fed. 909 (1893); *Ohio, etc. R. Co. v. Indianapolis, etc. R. Co.*, 5 Am. L. Reg. (N. S.) 733 (1866); *Attorney General v. Great Eastern R. Co.*, L. R. 11 Ch. Div. 449 (1879); *Johnson v. Shrewsbury, etc. R. Co.*, 3 De Gex, M. & G. 914 (1853); *Gardner v. London, etc. R. Co.*, L. R. 2 Ch. App. 212 (1867); *Beman v. Rufford*, 6 Eng. L. & Eq. 106 (1851), (15 Jur. 914).

Under the English Railway Clauses Consolidation Act (8 and 9 Viet. ch. 20), it has been held that one railroad company may make a contract with another for the use of its line and may pay tolls sufficient to make dividends upon the preference stock of the latter. *South Yorkshire R., etc. Co. v. Great Northern R. Co.*, 9



The power of a railroad company to accept a grant of running privileges depends upon the limitations of its charter. It cannot exercise running powers over a railroad beyond its authorized *termini*. It cannot use a trackage contract as a means of extending the limits within which it may operate a railroad.<sup>1</sup> But, within the limits prescribed by its charter, a railroad company has implied power to acquire running privileges over the railroad of another company, wherever such privileges furnish it an advantageous means of reaching a desired point.<sup>2</sup>

§ 257. **Execution of Trackage Contracts.** — The corporate power — implied or expressly conferred — involved in the authorization and execution of a trackage contract may be exercised by the board of directors of a railroad company in the management of the regular business of the corporation.<sup>3</sup> The power of the directors, however, is not so exclusive as to preclude action by the stockholders.<sup>4</sup>

The New York Court of Appeals has intimated that the right conferred by a statute authorizing a railroad company to “intersect, join and unite its railroad with any other railroad”

Exch. 55 (1853). *Contra*, Simpson v. Denison, 10 Hare, 51 (1852); compare Green Bay, etc. R. Co. v. Union Steamboat Co., 107 U. S. 98 (1882), (2 Sup. Ct. Rep. 221).

In Charlton v. Newcastle, etc. R. Co., 5 Jur. (N. S.) 1096 (1859), a contract for the joint use of railroads and division of profits, antecedent to an amalgamation, was declared *ultra vires* and void.

<sup>1</sup> Naugatuck R. Co. v. Waterbury Button Co., 24 Conn. 482 (1856); London, etc. R. Co. v. London, etc. R. Co., 4 De G. & J. 362 (1859); Simpson v. Denison, 10 Hare, 51 (1852); Ohio, etc. R. Co. v. Indianapolis, etc. R. Co., 5 Am. L. Reg. (N. S.) 733 (1866).

<sup>2</sup> Midland R. Co. v. Great Western R. Co., L. R. 8 Ch. App. 841 (1873); Great Northern R. Co. v. Manchester, etc. R. Co., 5 De Gex & Sm. 138 (1851).

<sup>3</sup> Elkins v. Camden, etc. R. Co., 36 N. J. Eq. 241 (1882). See also Nashua, etc. R. Co. v. Boston, etc. R. Co., 27 Fed. 821 (1886), reversed on other grounds, 136 U. S. 356 (1890), (10 Sup. Ct. Rep. 1004).

Where a trackage contract from a railroad company to a receiver of another company provided that any purchaser of the road of the latter company at foreclosure sale might elect to continue the contract, it was held that the use of the tracks by a purchaser at such sale for five years, paying the stipulated rental which was accepted, would be deemed an election to continue the contract, and would bind both parties.

Terre Haute, etc. R. Co. v. Peoria, etc. R. Co., 167 Ill. 296 (1897), (47 N. E. Rep. 513).

<sup>4</sup> Union Pacific R. Co. v. Chicago, etc. R. Co., 163 U. S. 564 (1895), (16 Sup. Ct. Rep. 1173).

upon the property of the company owning the latter railroad, and requiring such company "to grant the facilities" needed for the purpose, is an interest in lands which can only be created by a written instrument.<sup>1</sup> It may well be doubted, however, apart from statutory provision whether a mere trackage contract running for less than a year comes within the Statute of Frauds.<sup>2</sup>

§ 258. **Assignability of Trackage Contracts.** — A trackage contract, upon consideration, while partaking of the nature of a license, is essentially a valid and enforceable contract between the parties.<sup>3</sup>

It is, however, a license in the sense that it confers a personal privilege. A railroad company in letting another corporation into the use of its tracks agrees only that that particular corporation may exercise the privilege. A trackage contract creates no transferable interest, and, without a stipulation to that effect, is not assignable.<sup>4</sup>

<sup>1</sup> *Port Jervis, etc. R. Co. v. New York, etc. R. Co.*, 132 N. Y. 439 (1892), (30 N. E. Rep. 855, 52 Am. & Eng. R. Cas. 107).

<sup>2</sup> Where an oral agreement for trackage rights has been executed an action will lie for use and occupation.

*South Carolina Terminal Co. v. South Carolina, etc. R. Co.*, 52 S. C. 1 (1898), (29 S. E. Rep. 565).

<sup>3</sup> *Louisville, etc. R. Co. v. Kentucky, etc. R. Co.*, 95 Ky. 550 (1894), (26 S. W. Rep. 532).

<sup>4</sup> *Coney Island, etc. R. Co. v. Brooklyn Cable Co.*, 53 Hun (N. Y.), 171 (1889), (6 N. Y. Supp. 108): "The question is not whether a corporation can sell or assign its franchises, but whether the agreement in question became vested in the defendant so that it can enforce it against the plaintiff. This agreement was not a lease, and is, therefore, not a subject of subletting to different parties to be conjointly used with the original parties."

*South Side, etc. R. Co. v. Second Avenue R. Co.*, 191 Pa. St. 509

(1899), (43 Atl. Rep. 346): "The Pittsburgh and Birmingham Company was the owner of the tracks (*de facto* at least for a term of years) and the Second Avenue Passenger Railway Company was a licensee, or at most a sub-lessee. The latter had no rights but those the agreement gave it, the former had all the rights of ownership that the agreement did not part with. This is explicitly recognized in the provision that if it should allow any other company as licensee to use its tracks a proportionate credit should be allowed the Second Avenue company. The allowance of another company to come in as a licensee was by virtue of the rights of ownership. The latter company had no such rights, and could not divide or share or part with its privileges, except to an assignee within the terms of the agreement."

Under a contract for the use of terminal facilities, tracks, etc., by one railroad company with another, containing a provision that the

§ 259. **Construction of Trackage Contracts.** — The term of a trackage contract is fixed by the stipulations therein. When no time is stated it seems clear, as a general rule, that the contract is terminable at the option of either party after reasonable notice. An intention to make a perpetual arrangement should be clearly expressed.<sup>1</sup>

In an English case, however, it was held that an agreement between two railway companies wherein one was granted running powers and the other certain facilities for making shipments, and containing mutual stipulations as to the shipment of goods over each other's lines, but not containing any provision as to the time for which it should endure, was a permanent and not a terminable contract, and that a notice to terminate was invalid.<sup>2</sup> But as this contract was authorized

grantee should not, by any contract with any other railroad corporation, give to such corporation the right for its trains to pass over or use the railroad of the grantor without its consent, it was held that the right to use such tracks, etc., did not pass to the successors or assigns of the grantee without the consent of the grantor under the provisions of the contract. *Terre Haute, etc. R. Co. v. Peoria, etc. R. Co.*, 61 Ill. App. 405 (1895).

Where a trackage contract, in terms, runs to the assignees of the parties, and both parties recognize another company as the successor in interest of one of them, "a court of equity will treat the assignee in fact as the legal assignee, possessed of the rights and charged with the obligations of the original party to the contract." *Chicago, etc. R. Co. v. Denver, etc. R. Co.*, 143 U. S. 608 (1891), (12 Sup. Ct. Rep. 479), *affirming* 45 Fed. 304 (1891), s. c. 46 Fed. 145 (1890).

<sup>1</sup> In *Boston, etc. R. Co. v. Boston, etc. R. Co.*, 5 Cush. (Mass.) 375 (1850), it was held that the right granted by the legislature to one railroad company to use the tracks of another did not become, upon its exercise, a permanent contract be-

tween the corporations, for such use, perpetual in its character, but that "it was rather in the nature of a lease for an indefinite period of time, with liability to pay as long as it might be used." It was also held that no perpetual obligation to use the tracks could be inferred from an obligation imposed upon the proprietary company to make expensive and permanent additions to its property to accommodate such use. See also *Canal, etc. R. Co. v. St. Charles Street R. Co.*, 44 La. Ann. 1069 (1892), (11 So. Rep. 702).

A trackage contract is not invalid because, within its prescribed duration, the charter of one of the companies expires by limitation, provision being made in the contract for such contingency. *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 163 U. S. 592 (1895), (16 Sup. Ct. Rep. 1173).

<sup>2</sup> *Llanelly, etc. R. Co. v. London, etc. R. Co.*, L. R. 7 H. L. Cas. 550 (1875), (45 L. J. Ch. D. 539, 23 W. R. 927, 32 L. T. 575). In this case Lord Cairns compared trackage contracts with contracts of partnership and of hiring and service in respect to their terminable nature (p. 559): "Reference was made to the well-known cases of contracts of hiring

by the Railway Clauses Act, under which, in case any differences arose in its working, they might be made the subject of arbitration, the decision cannot be considered of general application.

Where one railroad company grants to another the right to use a portion of its line, it necessarily undertakes to furnish those facilities necessary to the exercise of the privilege granted. Thus, in an English case, where one railroad company had acquired running powers over the line of another and had equipped it with the block signal system, it was held that the latter company was bound to work the system — that it was a reasonable facility which the company was bound to afford.<sup>1</sup>

Where two railroad companies entered into a contract wherein the use of certain tracks and terminal facilities was granted, it was held that the expenses necessary to such use and the exercise of such facilities must be borne entirely by the grantor company.<sup>2</sup>

and service and contracts of partnership. These cases appear to me to have no analogy whatever to the present. With regard to contracts of hiring and service, assigning to each of them certain notices by which they can be terminated; and they are, besides, engagements which depend upon the personal confidence which one of the parties reposes in the other and which in their nature cannot be supposed to be of a perpetual character. With regard to contracts of partnership they also are already ruled and settled, by law, to be capable of termination at any moment unless a definite limit is prescribed upon the face of them. And, the law being well settled, when you have a contract of that kind, you apply the understood law, and you hold that the parties knowing what the law was, must be supposed to have intended to enter into a partnership which could at any time be terminated if they did not provide upon the face of their contract that it should be a continuing partnership."

In *Railway Co. v. Neel*, 56 Ark.

279 (1892), (19 S. W. Rep. 963), a trackage contract was held not to constitute a partnership between the railroad companies, and not to make one company the agent of the other for the purpose of receiving freight. The Court said (p. 287): "The contract between the two railway companies did not constitute a partnership between them nor did it make the Swan Lake railroad the agent of the appellant company for the purpose of receiving freight for and on its behalf. . . . The contract plainly intended to confer a license upon the Swan Lake railroad to run its trains over the appellant company's track between Bob Roy and Pine Bluff. It created no other right, unless it was to limit the appellant's rights to make certain charges for freight and passengers."

<sup>1</sup> *Great Western R. Co. v. Bristol Port R., etc. Co.*, 5 Ry. & C. T. Cases, 94 (1885).

<sup>2</sup> *Elmira Rolling Mill Co. v. Erie R. Co.*, 28 N. J. Eq. 400 (1877), (14 Am. Ry. Rep. 199).

A contract by which one company

The rights of the parties under a truckage contract are measured, with respect to the use of track, by the terms of the contract, and the provisions of the Interstate Commerce Act apply to the situation and cannot authorize a different use of the track.<sup>1</sup>

A stipulation in a contract between three railroad companies respecting the use of a common yard that the "necessary expenses" should be equally shared among them, did not include the extraordinary expense of a judgment obtained against one of the companies for injuries sustained by an employee, through its negligence.<sup>2</sup> But, under an agreement

granted to another a running privilege into a city provided for the payment of a certain sum for each car drawn over the first company's track, "excepting only empty freight cars and such loaded freight cars as . . . are hauled over said first party's line of railroad." *Held*, that the exemption was not ambiguous, and that the first clause covered all freight cars. *Louisville, etc. Co. v. Louisville S. R. Co.*, 100 Ky. 690 (1897), (39 S. W. Rep. 42).

One railroad company granted to another the joint use of its terminal property and of a short track running to it under an agreement providing that if the business required it additional property should be acquired by one or both companies and included in the joint use. The licensee company subsequently purchased additional property and a readjustment of the rental was made. In all the agreements provision was made for apportioning the cost of maintenance etc. upon a wheelage basis — the "car and engine mileage use of said property." It was held that the agreements contemplated the joint use of the property as a whole and that wheelage was to be computed on cars and engines passing to the terminal property over the short track without regard to whether they actually used the part of the terminal property owned by the proprietary company.

*Columbus, etc. R. Co. v. Pennsylvania Co.*, 143 Fed. 757 (1906).

Two railroad companies entered into a contract by which one obtained from the other the permanent right to use, jointly with the proprietary company, a portion of its tracks. This use continued until the licensee company became insolvent and all its property and franchises were sold to another company, which for some time used the tracks as before. Subsequently the purchasing company abandoned such use, but it was held that it had become liable for the obligations of the licensee company.

*South Carolina R. Co. v. Wilmington, etc. R. Co.*, 7 S. C. 410 (1875).

<sup>1</sup> The duty of a railroad company, operating its own road, to serve the local stations on its lines, does not apply to a company that has only a running privilege for through trains over a part of the road of another company which it does not control. In such a case the company is not required to disregard the conditions of its agreement, and does not violate the provisions of the Interstate Commerce Act by not receiving and discharging traffic on the tracks of the proprietary company. *Alford v. Chicago, etc. R. Co.*, 2 Int. Com. Rep. 771 (1890).

<sup>2</sup> *Gulf, etc. R. Co. v. Galveston, etc. R. Co.*, 83 Tex. 509 (1892), (18 S. W. Rep. 956, 52 Am. & Eng. R. Cas. 99).

between the parties to such a contract that the cost of maintaining the tracks jointly used should be jointly borne, it was held that damages paid to employees injured while engaged in the work of maintenance were a part of the cost of maintenance and properly chargeable to the joint account.<sup>1</sup>

A provision in a trackage contract between two street railroad companies that, in case the licensee company should use steam as a motive power, either party might terminate the contract upon six months' notice was held not to authorize such termination upon the ground that the licensee had installed an electrical system.<sup>2</sup>

The practical construction which the parties to a trackage contract have put upon it is a safe guide to the intention of the parties when its meaning is in doubt.<sup>3</sup>

§ 260. **Specific Performance of Trackage Contracts.** — Trackage contracts are of such a nature that, as a general rule, a judgment for damages would furnish an inadequate remedy for their breach. When such a contract is not unconscionable or inequitable and the company seeking its enforcement has

Under a contract by a city with a railroad company by which it permits the company to construct a track through its streets, on condition that the company permit other railroad companies to use the track, on paying a *pro rata* share of the cost of construction, without placing any limit on the time when other roads may come in, or their number, a delay in making application of nine years after its completion, during which two other roads have come in, is no ground for excluding an applicant. *Louisville, etc. R. Co. v. Mississippi, etc. R. Co.*, 92 Tenn. 681 (1893), (22 S. W. Rep. 920).

<sup>1</sup> *Louisville, etc. R. Co. v. Chesapeake, etc. R. Co.*, 21 Ky. Law Rep. 875 (1899), (53 S. W. Rep. 277).

<sup>2</sup> *Prospect Park, etc. R. Co. v. Coney Island, etc. R. Co.*, 144 N. Y. 152 (1894), (39 N. E. Rep. 17, 26 L. R. A. 610).

As to construction of a trackage contract in view of consolidation —

whether it extends to subsequently acquired lines, see *Lancashire, etc. R. Co. v. East Lancashire, etc. R. Co.*, 5 H. L. Cas. 792 (1856), (2 Jur. (N. S.) 767, 25 L. J. Ex. 278).

<sup>3</sup> *Columbus, etc. R. Co. v. Pennsylvania Co.*, 143 Fed. 757 (1906): "This not so clearly from the unaided construction of the language of the contract . . . but because of the construction which the parties for so many years of operation under the contract put upon it. This is a very safe guide in cases of doubt in finding the intention of the parties. Their concurrent action in taking up the execution of their contract, while their minds were still conscious of the understanding they had when making it and pursuing its execution without question, may, with confidence, be relied upon as indicating what they meant when they made it."

See also *Chicago Great Western R. Co. v. Northern Pacific R. Co.*, 101 Fed. 792 (1900).

acted in good faith, a court of equity will decree its specific performance. It is not an objection to such a decree that it involves continuous acts and constant supervision. The court will adapt the remedy to the wrong.<sup>1</sup>

In *Union Pacific R. Co. v. Chicago, etc. R. Co.*<sup>2</sup> Mr. Chief Justice Fuller said: "The jurisdiction of courts of equity to decree the specific performance of agreements is of a very ancient date, and rests on the ground of the inadequacy and incompleteness of the remedy at law. Its exercise prevents the intolerable travesty of justice involved in permitting parties to refuse performance of their contracts at pleasure by electing to pay damages for the breach. It is not contended that multiplicity of suits to recover damages for the refusal of defendants to perform would afford adequate relief, nor could it be, for such a remedy, under the circumstances, would neither be plain nor complete, nor a sufficient substitute for the remedy in equity, nor would the interests of the public be subserved thereby. But it is objected that equity will not decree specific performance of a contract requiring continuous acts involving skill, judgment and technical knowledge, nor enforce agreements to arbitrate, and that this case occupies that attitude. We do not think so. The decree is complete in itself, is self-operating and self-executing, and the provision for referees in certain contingencies is a mere matter of detail and not of the essence of the contract. It must not be forgotten that,

<sup>1</sup> *United States: Union Pacific R. Co. v. Chicago, etc. R. Co.*, 163 U. S. 564 (1895), (16 Sup. Ct. Rep. 1173), *affirming* 51 Fed. 309 (1892); s. c. 47 Fed. 15 (1891); *Joy v. City of St. Louis*, 138 U. S. 1 (1891), (11 Sup. Ct. Rep. 243); *affirming* s. c. *sub nom.* *Central Trust Co. v. Wabash, etc. R. Co.*, 29 Fed. 546 (1886); *Railroad Co. v. Alling*, 99 U. S. 463 (1878).

A trackage contract for a long term of years with rental on a wheelage basis, is specifically enforceable in equity upon the ground of the avoidance of a multiplicity of suits which would afford inadequate relief and be vexatious and expensive.

*Grand Trunk Western R. Co. v.*

*Chicago, etc. R. Co.*, 141 Fed. 785 (1905).

*Alabama: South, etc. R. Co. v. Highland, etc. R. Co.*, 98 Ala. 400 (1893), (13 So. Rep. 682, 39 Am. St. Rep. 74).

*New York: Prospect Park, etc. R. Co. v. Coney Island, etc. R. Co.*, 144 N. Y. 152 (1894), (39 N. E. Rep. 17, 26 L. R. A. 610); *Lawrence v. Saratoga Lake R. Co.*, 36 Hun, 467 (1885).

*England: Wolverhampton, etc. R. Co. v. London, etc. R. Co.*, L. R. 16 Eq. 433 (1873).

<sup>2</sup> *Union Pacific R. Co. v. Chicago, etc. R. Co.*, 163 U. S. 600 (1895), (16 Sup. Ct. Rep. 1173).

in the increasing complexities of modern business relations, equitable remedies have necessarily and steadily been expanded, and no inflexible rule has been permitted to circumscribe them. As has been well said, equity has contrived its remedies 'so that they shall correspond both to the primary right of the injured party, and to the wrong by which that right has been violated;' and 'has always preserved the elements of flexibility and expansiveness, so that new ones may be invented, or old ones modified, in order to meet the requirements of every case, and to satisfy the needs of a progressive social condition in which new primary rights and duties are constantly arising and new kinds of wrongs are constantly committed.' " 1

§ 261. **Liability of Proprietary Company to Third Persons.** — Upon the principle that a corporation owing duties to the public cannot shift the responsibility for their performance without the consent of the State, a railroad company, permitting another company to use its tracks, remains liable for injuries to third persons — passengers, travellers at crossings and others — caused by the negligence of employees of the latter company in running its trains, to the same extent as if they were its own employees upon its own trains. The negligence of the licensee company is the negligence of the proprietary company.<sup>2</sup>

<sup>1</sup> Pom. Eq. Jur. § 111.

<sup>2</sup> *United States*: Central Trust Co. v. Denver, etc. R. Co., 97 Fed. 239 (1899).

*Georgia*: Central R., etc. Co. v. Perry, 58 Ga. 461 (1877).

*Illinois*: Pennsylvania Co. v. Ellett, 132 Ill. 654 (1890), (24 N. E. Rep. 559); Peoria, etc. R. Co. v. Lane, 83 Ill. 448 (1876); Toledo, etc. R. Co. v. Rumbold, 40 Ill. 143 (1866); Pennsylvania R. Co. v. Greso, 79 Ill. App. 127 (1898); Cleveland, etc. R. Co. v. Bender, 69 Ill. App. 262 (1896).

In *Pittsburgh, etc. R. Co. v. Campbell*, 86 Ill. 443 (1877), the lessee of a railroad, who, by contract, permitted another company to use its road, was

held liable for the negligence of the latter company.

*Indiana*: Indianapolis, etc. R. Co. v. Solomon, 23 Ind. 534 (1864).

*Kentucky*: Louisville, etc. R. Co. v. Breeden's admx., 111 Ky. 729 (1901), (64 S. W. Rep. 667).

*Minnesota*: Heron v. St. Paul, etc. R. Co., 68 Minn. 542 (1897), (71 N. W. Rep. 706).

*Missouri*: Sinclair v. Missouri, etc. R. Co., 70 Mo. App. 588 (1897).

*New Jersey*: Delaware, etc. R. Co. v. Salmon, 39 N. J. L. 299 (1877), (23 Am. Rep. 214).

*New York*: Compare *Cain v. Syracuse, etc. R. Co.*, 20 Misc. 459 (1897), (45 N. Y. Supp. 538), affirmed 27 App. Div. 376 (1898), (50 N. Y. Supp. 1).



In *Pennsylvania Co. v. Ellett*<sup>1</sup> the Supreme Court of Illinois said: "The law has become settled in this State, by an unbroken line of decisions, that the grant of a franchise, giving the right to build, own and operate a railway, carries with it the duty to so use the property and manage and control the railroad as to do no unnecessary damage to the person or property of others; and where injury results from the negligent or unlawful operation of the railroad, whether by the corporation to which the franchise is granted, or by another corporation, or by individuals whom the owner authorizes or permits to use its tracks, the company owning the railway and franchise will be liable. . . . The public may look for indemnity for injury resulting from the wrongful or unlawful operation of the road, to that corporation to which they have granted the franchise, and thus delegated a portion of the public service; and for this purpose the company whom it permits to use its tracks, and its servants and employees, will be regarded as the servants and agents of the owner company."<sup>2</sup>

*North Carolina*: *Aycock v. Railroad Co.*, 89 N. C. 321 (1883). Compare *Sellars v. Richmond, etc. R. Co.*, 94 N. C. 654 (1886), (25 Am. & Eng. R. Cas. 451) — a case in which a correct result is reached through a manifestly erroneous course of reasoning.

*Texas*: *Ray v. Pecos, etc. R. Co.* 35 Tex. Civ. App. 123 (1904), (80 S. W. Rep. 112).

*Wisconsin*: *Jefferson v. Chicago, etc. R. Co.*, 117 Wis. 549 (1903), (94 N. W. Rep. 289). In this case where it was sought to recover damages from the owner of a railroad caused by fire resulting from the failure of the licensee to use a proper spark arrester the Court said (p. 552): "When a railroad company permits another to make joint use of its track, it is liable for injuries caused to persons or property for the actionable negligence of such licensee. It has received its franchises subject to certain well-defined duties as to the machinery which it uses. It cannot, while exercising their franchises allow

others to come in with defective machinery and use the quasi-public highway jointly with it and escape the duty laid upon it by its charter to use safe machinery."

*England*: In England as railway companies are compelled to grant running powers to other companies, an absolute liability for the negligence of the working company is manifestly inequitable. The rule of liability there is: The proprietary company is *prima facie* liable for injuries received upon its lines, but is entitled to show that the injury was caused by the negligence of another company in violation of the latter's agreement to provide for the safety of its trains. *Ayles v. South Eastern R. Co.*, L. R. 3 Ex. 146 (1868), (37 L. J. Ex. 104).

<sup>1</sup> *Pennsylvania Co. v. Ellett*, 132 Ill. 659 (1890), (24 N. E. Rep. 559).

<sup>2</sup> The fact that a railroad company grants to another company a right to use its tracks does not furnish an owner of land over which the proprietary company has acquired a

§ 262. **Liability of Licensee Company to Third Persons.** — A railroad company operating trains upon the tracks of another company under a trackage contract is liable for its own negligence.<sup>1</sup> Its responsibility for its acts and omissions is not affected by the fact that the proprietary company is also liable.

A licensee railroad company is liable for something more than the negligence of its own employees. When it obtains the right to run its trains over the tracks of another company it makes the tracks so used its own, to the extent that it is responsible to persons injured upon or by its trains for any failure to maintain the tracks in a safe condition.<sup>2</sup> It is like-

right of way, any ground for claiming additional damages. *Miller v. Green Bay, etc. R. Co.*, 59 Minn. 169 (1894), (60 N. W. Rep. 1006, 26 L. R. A. 443).

<sup>1</sup> *Illinois*: *Pennsylvania Co. v. Ellett*, 132 Ill. 654 (1890), (24 N. E. Rep. 559); *Wabash, etc. R. Co. v. Peyton*, 106 Ill. 534 (1883), (46 Am. Rep. 705); *Peoria, etc. R. Co. v. Lane*, 83 Ill. 448 (1876); *Toledo, etc. R. Co. v. Rumbold*, 40 Ill. 143 (1866); *St. Louis, etc. R. Co. v. Rowley*, 90 Ill. App. 653 (1900); *Pennsylvania R. Co. v. Greso*, 79 Ill. App. 127 (1898); *Cleveland, etc. R. Co. v. Bender*, 69 Ill. App. 262 (1896).

The fact that the company owning a railroad track upon which a collision occurred was also negligent, does not excuse the negligence of another company using such track under an agreement with the owner. *Chicago, etc. R. Co. v. Mitchell*, 70 Ill. App. 188 (1897).

*Indiana*: *Cleveland, etc. R. Co. v. Berry*, 152 Ind. 607 (1899), (53 N. E. Rep. 415, 46 L. R. A. 33); *Pittsburgh, etc. R. Co. v. Thompson*, 21 Ind. App. 355 (1898), (50 N. E. Rep. 828); *Wabash R. Co. v. Williamson*, 3 Ind. App. 190 (1891). *Compare Cincinnati, etc. R. Co. v. Paskins*, 36 Ind. 380 (1871), (5 Am. Ry. Rep. 570); *Cincinnati, etc. R. Co. v. Townsend*, 39 Ind. 38 (1872).

*Kansas*: *Chicago, etc. R. Co. v. Posten*, 59 Kan. 449 (1898), (53 Pac. Rep. 465); *Chicago, etc. R. Co. v. Martin*, 59 Kan. 437 (1898), (53 Pac. Rep. 461); *Chicago, etc. R. Co. v. Groves*, 56 Kan. 601 (1896), (44 Pac. Rep. 628).

*Maine*: *Webb v. Portland, etc. R. Co.*, 57 Me. 117 (1869).

*Missouri*: *Sinclair v. Missouri, etc. R. Co.*, 70 Mo. App. 588 (1897).

*New York*: *McGrath v. New York Central, etc. R. Co.*, 63 N. Y. 522 (1876); *Leonard v. New York Central, etc. R. Co.*, 10 J. & S. (Sup. Ct.) 225 (1877).

For consideration of liability of licensee company to proprietary company for its negligence see *Central Trust Co. v. Colorado Midland R. Co.*, 89 Fed. 560 (1898).

<sup>2</sup> Where a railroad company procures, by contract with another company, the right of running its trains into and out of a depot over the track of the latter, it thereby makes that portion of the track so used its own, in so far that it will be responsible for all injuries resulting from negligence in keeping or permitting it to be in an unsafe condition. *Wabash, etc. R. Co. v. Peyton*, 106 Ill. 534 (1883), (46 Am. Rep. 705).

In *St. Louis, etc. R. Co. v. Rowley*, 90 Ill. App. 656 (1900), the Court said: "The right of way of the track

wise liable to persons so injured for the negligence of the employees of the proprietary company in the operation of that portion of the road over which it has running privileges. To that extent they become its employees.<sup>1</sup>

upon which plaintiff in error's train was running, belonged to the C. P. & St. L. Ry. Co., which company managed and cared for it, the defendant in error paying for using the rails upon a wheelage basis. This fact would not, however, excuse defendant in error for damages caused by the condition of the right of way. When it, as a common carrier, used the tracks upon such right of way, it became liable for damages caused by its improper condition to the same extent as if it owned or leased it." *Semble* that a licensee company is liable for damages occasioned by a failure to maintain fences, Toledo, etc. R. Co. v. Rumbold, 40 Ill. 143 (1866). And see Pittsburgh, etc. R. Co. v. Thompson, 21 Ind. App. 355 (1898), (50 N. E. Rep. 828) (under the *Indiana* Statute). See also Sinclair v. Missouri, etc. R. Co., 70 Mo. App. 588 (1897); Louisville, etc. R. Co. v. Breeden's Admx., 111 Ky. 729 (1901), (64 S. W. Rep. 667).

<sup>1</sup> In *Leonard v. New York Central, etc. R. Co.*, 10 J. & S. 233 (1877), the New York Supreme Court said: "When various companies run trains over the same road in a large city intersected by the crossings of streets, the protection of citizens in the use of the streets should not depend upon inquiries to be made of the signalling flagmen of the road, as to which company employs them, or whether they were duly authorized to signal danger or safety as this or that train passes. It must be assumed in such exigencies, that when a company chooses to run trains over a road guarded by flagmen that it elects to be protected by these flagmen properly discharging their duties, and to be made liable in

case they neglect them. . . . The law does not give immunity from liability to a company operating its trains negligently, because it appears that it operates them upon a road and with a signal service that belongs to another company. As far as the person injured in passing over the crossing by such company's train is concerned, it is immaterial to whom the road or its signal service or its other appurtenances belong that are in use at the crossing. The duty primarily devolves upon the company running the train, that there shall be no negligence in respect to these matters as far as persons crossing are affected."

See also *McGrath v. New York Central, etc. R. Co.*, 63 N. Y. 522 (1876); *Chicago, etc. R. Co. v. Posten*, 59 Kan. 449 (1898), (53 Pac. Rep. 465); *Wabash, etc. R. Co. v. Peyton*, 106 Ill. 534 (1883), (46 Am. Rep. 705); *Pennsylvania R. Co. v. Greso*, 79 Ill. App. 127 (1898).

A railroad company using the tracks of another company is liable for the negligence of its employees, although they operate the train under the orders of the other company. *Chicago, etc. R. Co. v. Martin*, 59 Kan. 437 (1898), (53 Pac. Rep. 461). See also *Chicago, etc. R. Co. v. Groves*, 56 Kan. 601 (1896), (44 Pac. Rep. 628).

In *Patterson v. Wabash, etc. R. Co.*, 54 Mich. 91 (1884), (19 N. W. Rep. 761, 18 Am. & Eng. R. Cas. 130), a passenger recovered judgment against the corporation with which he had contractual relations for injuries caused by the negligence of a corporation using, in common with it, tracks of a third corporation.

The rule of liability is, clearly, that a railroad company, operating under a trackage contract, is liable to a passenger, or person lawfully upon the tracks, injured by its trains, to the same extent as if it owned the road.

§ 263. **Liability to Employees.** — Where one railroad company has the right, under a trackage contract, to run its trains over the track of another company, the latter company is liable to employees of the former company for injuries occasioned by the negligence of its switchmen and employees engaged in the work of maintaining and protecting the tracks.<sup>1</sup> The proprietary company, under a trackage contract, is bound to furnish a safe track for the trains of the licensee and is responsible to employees of the licensee for any injuries caused by defects in the tracks or roadbed.<sup>2</sup>

The licensee company is liable to employees of the proprietary company for injuries caused by its negligent running of trains.<sup>3</sup> It is also, of course, liable to its own employees for any failure to perform its duty as master.<sup>4</sup>

Where several railroad companies have running privileges over the tracks of another company, the proprietary company is not liable to employees of one licensee company for injuries received through the negligence of employees of another licen-

<sup>1</sup> *Merrill v. Railroad Co.*, 54 Vt. 200 (1881); *Southern Kansas R. Co. v. Sage* (Tex. Civ. App. 1904), 80 S. W. Rep. 1038.

<sup>2</sup> *Killian v. Augusta, etc. R. Co.*, 79 Ga. 234 (1867), (4 S. E. Rep. 165).

In *Clark v. Chicago, etc. R. Co.*, 92 Ill. 43 (1879), the Court held that an employee of a proprietary company, injured through the negligence of employees of a licensee company, in violating the rules of the proprietary company, could not recover damages from the proprietary company — the accident arising from a peril of the service of which the employee had knowledge, and not from any negligence of the proprietary company.

<sup>3</sup> *Lockhart v. Little Rock, etc. R. Co.*, 40 Fed. 631 (1889).

In *Wabash R. Co. v. Keeler*, 127 Ill. App. 265 (1906) it was held that both the proprietary company and the licensee company are liable for injuries to employees of the former.

<sup>4</sup> Where the owners of a private railway track occasionally used by a railroad company for a special purpose negligently suffered it to remain in a dangerous condition for use, it was held that the railroad company was liable for an injury to its own employee caused by the defective condition of the roadbed — that it owed a duty to its employees to inspect the tracks before they were used and, if in a defective condition, used them at its peril.

*Stetler v. Chicago, etc. R. Co.*, 49 Wis. 609 (1880), (6 N. W. Rep. 303).

see company. Redress for such injuries must be furnished by the corporation whose employees are at fault.<sup>1</sup>

<sup>1</sup> *Georgia R., etc. Co. v. Friddell*, 79 Ga. 234 (1887), (7 S. E. Rep. 214, 11 Am. St. Rep. 410).

Where several railroad companies organize an association and share the expense of operating a line of railroad they will be jointly as well as

severally liable for any injury to their employees caused by a defective track upon the road so used by them.

*Wisconsin Central R. Co. v. Ross*, 142 Ill. 9 (1892), (31 N. E. Rep. 412, 34 Am. St. Rep. 49).

## PART IV

### CORPORATE STOCKHOLDING AND CONTROL

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#### CHAPTER XXV

#### POWER OF CORPORATION TO HOLD STOCK IN OTHER CORPORATIONS

##### *I. Rule that Statutory Authority is essential*

- § 264. Necessity for Statutory Authority to purchase Stock. Rule in United States.
- § 265. Necessity for Statutory Authority to purchase Stock. Rule in England.
- § 266. Necessity for Statutory Authority to subscribe for Stock.
- § 267. Subscriptions or Purchases through Trustees or Agents.
- § 268. Similar Nature of Corporations does not affect Application of Rule.
- § 269. Expediency of Purchase of Stock Immaterial.
- § 270. Assumption of Power to hold Stock in Articles of Association.

##### *II. Express Power to acquire Stock*

- § 271. Corporations may acquire Stock in other Corporations when authorized. Statutory Provisions.
- § 272. Power to subscribe for Stock in Foreign Corporations.
- § 273. Construction of Statutes.
- § 274. Construction of Constitutional Prohibitions.

##### *III. Incidental Power to acquire Stock*

- § 275. In General.
- § 276. Incidental Power to make Investments in Stocks.
- § 277. Incidental Power to take Stock in Satisfaction of Debt.
- § 278. Incidental Power to take Stock as Collateral.
- § 279. Incidental Power to acquire Stock in Connection with Consolidation or Purchase.
- § 280. Incidental Power to take Stock upon Reorganization.
- § 281. Incidental power to take Stock in Exchange for Corporate Assets.
- § 282. Miscellaneous Instances of Incidental Power to acquire Stock.
- § 283. Presumption of Power to hold Stock.
- § 283 a. An Analogous Power.

### I. Rule that Statutory Authority is essential

§ 264. **Necessity for Statutory Authority to purchase Stock. Rule in United States.** — The charter of a corporation is the measure of its powers. It can exercise only such powers as are conferred upon it, either in express terms or by necessary implication, in the law of its creation.<sup>1</sup>

The purchase of stock in another corporation involves a participation in a new and distinct enterprise. A corporation can make such a purchase only when expressly authorized to do so by statute, or when the power can be implied as incidental to the powers specifically granted.<sup>2</sup>

<sup>1</sup> Chief Justice Marshall in the Dartmouth College Case (*Dartmouth College v. Woodward*, 4 Wheat. (U. S.) 636 (1819)) said: "A corporation . . . being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

For cases stating this elementary principle as applicable to the power to purchase shares, see *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497); *Franklin Co. v. Lewiston Savings Inst.*, 68 Me. 43 (1877), (28 Am. Rep. 9).

<sup>2</sup> *United States*: *De la Vergne Co. v. German Savings Inst.*, 175 U. S. 40 (1899), (20 Sup. Ct. Rep. 20); *California Bank v. Kennedy*, 167 U. S. 362 (1897), (17 Sup. Ct. Rep. 831); *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 698 (1896), (16 Sup. Ct. Rep. 714); *First Nat. Bank v. Nat. Exch. Bank*, 92 U. S. 122 (1875); *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721 (1904); *Citizens State Bank v. Hawkins*, 71 Fed. 369 (1896); *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896); *Easun v. Buckeye Brewing Co.*, 51 Fed. 156 (1892); *Hamilton v. Savannah, etc. R. Co.*, 49 Fed. 412 (1892); *Mackintosh v. Flint, etc.*

*R. Co.*, 34 Fed. 582 (1888); *Sumner v. Marcy*, 3 Wood. & M. 105 (1847).

*Arkansas*: *Lester v. Bemis Lumber Co.*, 71 Ark. 379 (1903), (74 S. W. Rep. 518).

*California*: *Knowles v. Sandercock*, 107 Cal. 629 (1895), (40 Pac. Rep. 1047).

*Connecticut*: *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833).

*Georgia*: *Central R. Co. v. Collins*, 40 Ga. 582 (1869); *Hazlehurst v. Savannah, etc. R. Co.*, 43 Ga. 13 (1871).

*Illinois*: *People v. Pullman Car Co.*, 175 Ill. 125 (1898), (51 N. E. Rep. 664, 64 L. R. A. 366); *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497); *Martin v. Ohio Stove Co.*, 78 Ill. App. 105 (1898).

*Maine*: *Franklin Co. v. Lewiston Savings Inst.*, 68 Me. 43 (1877), (28 Am. Rep. 9): "In the United States, corporations cannot purchase, or hold, or deal in the stocks of other corporations, unless expressly authorized to do so by law." Quoting *Green's Brice's Ultra Vires* (2d. Am. Ed.), 91 note.

*Minnesota*: *Hunt v. Hauser Malt-ing Co.*, 90 Minn. 282 (1903), (96 N. W. Rep. 85).

That which is beyond the power of a corporation to do in the first instance cannot be made effective by any subsequent act or omission. An *ultra vires* contract for the purchase of stock by a corporation is void and cannot be validated by estoppel.<sup>1</sup>

Corporate purchases of stock have been declared contrary to public policy as well as *ultra vires*.<sup>2</sup> But where the corporation laws of a State at no time prohibited such purchases by corporations organized thereunder, it was held by a federal court that the enactment, under a new constitution, of laws authorizing such purchases showed that prior acquisitions of stocks by corporations were not against the public policy of the State, even if it did not expressly legalize the particular transactions.<sup>3</sup>

*Montana*: MacGinnis v. Boston, etc. Mining Co., 29 Mont. 428 (1904), (75 Pac. Rep. 89).

*New Hampshire*: Pearson v. Concord R. Corp., 62 N. H. 537 (1883), (13 Am. St. Rep. 590).

*New Jersey*: Elkins v. Camden, etc. R. Co., 36 N. J. Eq. 5 (1882).

*New York*: Milbank v. New York, etc. R. Co., 64 How. Pr. 20 (1862); Talmage v. Pell, 7 N. Y. 328 (1852); Nassau Bank v. Jones, 95 N. Y. 115 (1884), (47 Am. Rep. 14).

*Ohio*: Franklin Bank v. Commercial Bank, 36 Ohio St. 354 (1881), (38 Am. Rep. 594); Columbus, etc. R. Co. v. Burke, 19 Weekly Law Bull. 27 (1887).

*Tennessee*: Marble Co. v. Harvey, 92 Tenn. 115 (1892), (20 S. W. Rep. 427, 36 Am. St. Rep. 71, 18 L. R. A. 252).

*Washington*: Parsons v. Tacoma Smelting, etc. Co., 25 Wash. 508 (1901), (65 Pac. Rep. 765).

The rule that one corporation, without statutory authority, cannot purchase the stock of another is manifestly inapplicable to stockholders in corporations. As said in *State v. Butler*, 86 Tenn. 627 (1888), (8 S. W. Rep. 586): "We know of no principle of law that would prevent the stockholders in an insur-

ance company from becoming, at the same time, stockholders in bank, even where the same stockholders own all the stock in the two corporations."

<sup>1</sup> *Schofield v. Goodrich Bros. Banking Co.*, 98 Fed. 273 (1899).

In this case the Circuit Court of Appeals for the Eighth Circuit went somewhat further than the text and said: "The purchase of the stock of another corporation as an investment and not as security or in payment of a debt, by a corporation simply empowered to do a banking business, is beyond its power and void and, since such a purchase is *ultra vires* and void, it cannot be made good or validated by estoppel."

<sup>2</sup> In *Robotham v. Prudential Ins. Co.*, 53 Atl. Rep. 851 (N. J. Ch. 1903) the Court said: "There is also authority for the proposition that corporations cannot acquire and hold the stock of other corporations without express authorization under a statute, the origin of the prohibition, whether in the doctrine of *ultra vires* or in some positive rule of law founded upon public policy, being left in uncertainty." (Citing this section.)

<sup>3</sup> *Bancroft & Sons Co. v. Bloede*, 106 Fed. 396 (1901).

In *MacGinnis v. Boston, etc.*



§ 265. **Necessity for Statutory Authority to purchase Stock, Rule in England.** — The rule that purchases by one corporation of stock in another, without legislative authority, are *ultra vires* has not been adopted to its fullest extent in England. The rule there seems to be that a strictly private corporation "may deal in the shares of other corporations, without express power so to do, provided the nature of its business be such as to render such transactions conducive to its prosperity."<sup>1</sup>

With respect to railroad companies and other *quasi*-public corporations, however, the English courts strictly apply the

Mining Co., 29 Mont. 428 (1904), (75 Pac. Rep. 89) it was held that since the Montana constitution does not prohibit generally the consolidation of corporations, and statutes of the State expressly authorize the consolidation of mining corporations and empower such corporations to exchange their property for stock of other corporations, it is not against the public policy of the State to permit such corporations to hold and vote stock in other corporations of similar nature.

<sup>1</sup> Green's Brice's *Ultra Vires* (2d Am. Ed.), 91.

The rule, however, seems by no means well settled, and is based, principally, upon *dicta* of the judges.

*In re Barnard's Banking Co.*, L. R. 3 Ch. App. 105 (1867), Lord Cairns said: "There is no apparent or *prima facie* objection to a corporation so joining [by purchase of shares] with another corporation in trade. A trading corporation, as we well know, may enter into trade or partnership along with an individual. There is no reason at common law, so far as I know, why one corporation should not become a member of another corporate body." The real question at issue was, however, whether an *express* power to purchase shares was contrary to the statutes governing trading companies.

In *Royal Bank of India's Case*,

L. R. 4 Ch. App. 257 (1869), Lord Selwyn, after approving the judgment of Lord Cairns in the above case, said: "Looking at the question as a mere abstract question, in my judgment there is nothing to prevent a corporation from being a shareholder in another trading corporation."

Lord Giffard said (p. 262): "I quite agree that the *Royal Bank of India* had no authority to speculate in shares, and that if it had gone upon the *Stock Exchange* and bought shares as a speculation, such proceeding would have been *ultra vires*." In this case the transaction was a pledge, and the bank, under the American rule, had implied power to buy in the stock.

*In re Financial Corporation*, 28 W. R. 760 (1880), it was held that a corporation had power to purchase shares of other companies when it was organized for the purpose of "undertaking, assisting and participating, in financial, commercial and industrial operations . . . both singly, and in connection with other persons, firms, companies and corporations."

See also *Canada Life Assur. Co. v. Pell Mfg. Co.*, 26 Grant's Ch. (Canada) 486 (1879). Compare *Joint Stock Discount Co. v. Brown*, L. R. 8 Eq. 391 (1869).

American rule. Such corporations cannot, without statutory authority, purchase, take or deal in the stock of other corporations.<sup>1</sup>

In Maryland, the English rule concerning private corporations has been adopted and applied to all corporations.<sup>2</sup>

§ 266. **Necessity for Statutory Authority to subscribe for Stock.** — Statutes authorizing "persons" to accept a charter, or form a corporation under general laws, confer the privilege upon individuals and not upon corporations.<sup>3</sup> Upon this

<sup>1</sup> In *Great Eastern R. Co. v. Turner*, L. R. 8 Ch. 152 (1872), Lord Selborne said: "There is no authority to purchase [shares in another corporation] either in the name of the company, or in the name of the chairman, or in any other name. The company is a mere abstraction of law. All that it does, all that the law imputes to it as its act, must be that which can legally be done within the powers vested in it by law. Consequently, a thing which is *ultra vires*, and unauthorized, is not an act of the company in such a sense as that the consent of the company to that act can be pleaded."

In *Great Northern R. Co. v. Eastern Counties R. Co.*, 21 L. J. (Ch.) 840 (1851), one corporation desired to purchase stock in another, with the object of controlling the corporation. The Court said that it was an "attempt to carry into effect, without the intervention of Parliament, what cannot lawfully be done except by Parliament, in the exercise of its discretion with reference to the interest of the public."

See also *Great Western R. Co. v. Metropolitan R. Co.*, 32 L. J. Ch. 382 (1863), 9 Jur. (N. S.) 562; *Maunsell v. Midland Great Western R. Co.*, 1 Hem. & M. 130 (1863).

<sup>2</sup> In *Booth v. Robinson*, 55 Md. 419 (1880), it was held that one steam packet company might purchase the shares of another steam packet company. The Court said (p. 433), that,

"having money to loan, or invest, there would appear to be no reason why it may not invest in stock of other corporations as well as in other funds, provided it be done *bona fide*, and with no sinister or unlawful purpose." This decision is based upon the *dicta* in the English cases, cited in a preceding note. See also *Davis v. United States Electric Power, etc. Co.*, 77 Md. 39 (1893), (25 Atl. Rep. 982). Also *Elysville Mfg. Co. v. Okisko Co.*, 1 Md. Ch. Dec. 392 (1849), *affirmed* 5 Md. 152 (1853).

In *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 459 (1903), (75 Pac. Rep. 89) the Court said: "The general rule is that one corporation cannot hold or vote stock in another unless expressly authorized so to do by the terms of its charter or by a statute. This was formerly the rule in England; but it has been much relaxed by the later decisions, which recognize many exceptions. The general rule prevails in the State and federal courts in this country. Iowa and Maryland are, possibly, the only exceptions."

<sup>3</sup> A corporation is not a "person" within the meaning of the Louisiana statute authorizing the formation of a corporation by any number of "persons" not less than six. *Factors, etc. Ins. Co. v. New Harbor Protection Co.*, 37 La. Ann. 233 (1885).

Under a Washington statute providing that two or more "persons" may form a corporation, it has been

principle, and upon the general principle that the powers of a corporation are measured by the laws under which it is organized, it follows that a corporation, unless authorized by statute, cannot make a valid subscription to the capital stock of another corporation.<sup>1</sup>

Any such subscription made by a corporation, without statutory authority, is an *ultra vires* executory contract and is wholly void.<sup>2</sup> As said by the Supreme Court of Ohio in *Valley R. Co.*

held that although another statute provides that "person" shall be construed to include a corporation, a corporation cannot become a subscriber to shares in another corporation. *Denny Hotel Co. v. Schram*, 6 Wash. 134 (1893), (32 Pac. Rep. 1002, 36 Am. St. Rep. 137). See also *Parsons v. Tacoma Smelting, etc. Co.*, 25 Wash. 508 (1901), (65 Pac. Rep. 765); *Valley R. Co. v. Lake Erie Iron Co.*, 46 Ohio St. 44 (1888), (18 N. E. Rep. 486, 1 L. R. A. 412, 26 Am. & Eng. Corp. Cas. 56). See also *Lagrone v. Zimmerman*, 46 S. C. 372 (1895), (24 S. E. Rep. 290).

<sup>1</sup> *United States: Pauly v. Coronado Beach Co.*, 56 Fed. 428 (1893).

*Alabama: McAlister v. Florence Cotton, etc. Co.*, 128 Ala. 240 (1901), (30 So. Rep. 632); *Lanier Lumber Co. v. Rees*, 103 Ala. 622 (1893), (16 So. Rep. 637, 49 Am. St. Rep. 57); *Commercial Fire Ins. Co. v. Montgomery County*, 99 Ala. 1 (1891), (14 So. Rep. 490, 42 Am. St. Rep. 17).

*California: Knowles v. Sandercock*, 107 Cal. 629 (1895), (40 Pac. Rep. 1047).

*Connecticut: Mechanics Sav. Bank v. Meriden Agency Co.*, 24 Conn. 159 (1855).

*Georgia: Military Interstate Ass'n v. Savannah, etc. R. Co.*, 105 Ga. 420 (1898), (31 S. E. Rep. 200).

*Illinois: Martin v. Ohio Stove Co.*, 78 Ill. App. 105 (1898); *Peshtigo Co. v. Great Western Tel. Co.*, 50 Ill. App. 624 (1893).

*Louisiana: New Orleans, etc.*

*Steamship Co. v. Ocean Dry Dock Co.*, 28 La. Ann. 173 (1876), (26 Am. Rep. 90). See also *Factors, etc. Ins. Co. v. New Harbor Protection Co.*, 37 La. Ann. 233 (1885).

*Missouri: Newland Hotel Co. v. Lowe Furniture Co.*, 73 Mo. App. 135 (1898).

*Nebraska: Nebraska Shirt Co. v. Horton*, 93 N. W. Rep. 225 (1903).

*New Jersey: Central R. Co. v. Pennsylvania R. Co.*, 31 N. J. Eq. 475 (1879).

*New York: Berry v. Yates*, 24 Barb. 199 (1857).

*Ohio: Valley R. Co. v. Lake Erie Iron Co.*, 46 Ohio St. 44 (1888), (18 N. E. Rep. 486, 1 L. R. A. 412, 26 Am. & Eng. Corp. Cas. 56); *Smith v. Newark, etc. R. Co.*, 8 Ohio Cir. Ct. Rep. 583 (1894).

*Pennsylvania: McMillan v. Carson Hill Union Min. Co.*, 12 Phila. 404 (1878).

*Tennessee: McCampbell v. Fountain Head R. Co.*, 111 Tenn. 55 (1903), (77 S. W. Rep. 1072).

*Washington: Denny Hotel Co. v. Schram*, 6 Wash. 134 (1893), (32 Pac. Rep. 1002, 36 Am. St. Rep. 137).

<sup>2</sup> In *Lanier Lumber Co. v. Rees*, 103 Ala. 627 (1893), (16 So. Rep. 637, 49 Am. St. Rep. 57), the Court said: "It is equally clear, upon principle and authority, that all such subscriptions, or contracts of subscription [for stock in other corporations], are not voidable, but utterly void."

See also *McAlister Mfg. Co. v.*

*v. Lake Erie Iron Co.*:<sup>1</sup> "We think it is well settled, as a result of the decisions in this State, as well as elsewhere, that an incorporated company cannot, unless authorized by statute, make a valid subscription to the capital stock of another; that such subscription is *ultra vires*, and void."

§ 267. **Subscriptions or Purchases through Trustees or Agents.**—The rule that one corporation cannot, without statutory authority, become an incorporator or stockholder in another cannot be evaded by subscriptions or purchases made by persons in their own names but in behalf of a corporation.<sup>2</sup>

Florence Cotton, etc. Co., 128 Ala. 240 (1901), (30 So. Rep. 632); Peshigo Co. *v.* Great Western Tel. Co., 50 Ill. App. 624 (1893); Valley R. Co. *v.* Lake Erie Iron Co., 46 Ohio St. 44 (1888), (18 N. E. Rep. 486, 1 L. R. A. 412, 26 Am. & Eng. Corp. Cas. 56); New Orleans, etc. Steamship Co. *v.* Ocean Dry Dock Co., 28 La. Ann. 173 (1876), (26 Am. Rep. 90); Berry *v.* Yates, 24 Barb. (N. Y.) 199 (1857).

<sup>1</sup> Valley R. Co. *v.* Lake Erie Iron Co., 46 Ohio St. 49 (1888), (18 N. E. Rep. 486, 1 L. R. A. 412, 26 Am. & Eng. Corp. Cas. 56), *per* Minshall, J.

<sup>2</sup> Lanier Lumber Co. *v.* Rees, 103 Ala. 627 (1893), (16 So. Rep. 637, 49 Am. St. Rep. 57): "And it is too well settled to require discussion, that without such [statutory] authority one corporation cannot subscribe for, or invest its own capital in the shares of other corporations, either directly, as by becoming in its own name an incorporator of a new corporation, or indirectly, by subscriptions in the names of persons acting as agents and holding as trustees."

Martin *v.* Ohio Stove Co., 78 Ill. App. 108 (1898): "A corporation cannot become a stockholder in another corporation, especially when the object to be attained is the control of the latter. In the absence of express statutory authority, it cannot become an incorporator by subscribing for shares of a new cor-

poration, and it cannot do this indirectly through persons acting as its agents or tools. . . To permit the corporation, by its directors, to make the subscriptions in the individual names of the latter, thereby giving a semblance of compliance with the statute sufficient to secure the issuance of a certificate of incorporation, as was done in this case, and then by proceedings like the present, instituted by a person *in pari delicto*, compel the stockholders to transfer their shares to the corporation itself, would be to permit a person to take advantage of his own wrong to perpetuate a fraud upon the law, and to use a court of equity to aid in evading the law and setting it at naught."

And in Dunbar *v.* American Telephone, etc. Co., 224 Ill. 25 (1906), (79 N. E. Rep. 427) the Supreme Court of Illinois said: "Nor can it be seriously contended that a purchase by the company in the name of others, as agents or trustees, will relieve the transaction of its illegality. To hold otherwise would be to sustain a transaction illegal in its character, accomplished by indirection, when it could not be done if the methods were direct."

See also McCampbell *v.* Fountain Head R. Co., 111 Tenn. 55 (1903), (77 S. W. Rep. 1070); Central R. Co. *v.* Pennsylvania R. Co., 31 N. J. Eq. 475 (1879); Marble Co. *v.* Harvey,

A corporation cannot, by indirection, transcend its chartered powers.

In *Central R. Co. v. Pennsylvania R. Co.*, Chancellor Runyon said:<sup>1</sup> "A corporation cannot in its own name subscribe for stock, or be a corporator under the general railroad law; nor can it do so by a simulated compliance with the requirements of the law through its agents as pretended corporators and subscribers for stock."

§ 268. **Similar Nature of Corporations does not affect Application of Rule.** — The rule that corporations in the absence of statutory authority cannot acquire stock in other corporations, having its foundation in the limitations imposed upon corporate powers, is applicable both to corporations of a similar and a dissimilar nature.<sup>2</sup> A corporation has no more

92 Tenn. 118 (1892), (20 S. W. Rep. 427); *Nassau Bank v. Jones*, 95 N. Y. 115 (1884), (47 Am. Rep. 14); *Logan v. Courtown*, 12 Beav. 22 (1850).

<sup>1</sup> *Central R. Co. v. Pennsylvania R. Co.*, 31 N. J. Eq. 494 (1879).

In *Tecumseh, etc. Bank v. Russell*, 50 Neb. 277 (1897), (69 N. W. Rep. 763), it was held that where the cashier of a bank uses its funds to pay for stock in another bank, courts will hold that such stock belongs to the former bank, except as against *bona fide* purchasers.

## 2 I. CORPORATIONS OF SIMILAR NATURE

### A. Railroad Companies

*Central, etc. R. Co. v. Collins*, 40 Ga. 636 (1869): "A railroad company, without express authority given by the legislature to make the purchase, cannot purchase stock in another railroad company." See also *Hazlehurst v. Savannah, etc. R. Co.*, 43 Ga. 13 (1871), holding that a railroad company cannot buy stock in order to influence its management. Also *Milbank v. New York, etc. R. Co.*, 64 How. Pr. (N. Y.) 20 (1882); *Pearson v. Concord R. Corp.*, 62 N. H. 537 (1883), (13 Am. St. Rep. 590).

### B. Gas Companies

In *People v. Chicago Gas Trust Co.*, 130 Ill. 283 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497), Judge Magruder said: "Where a charter, in express terms, confers upon a corporation the power to maintain and operate works for the manufacture and sale of gas, it is not a necessary implication therefrom that the power to purchase stock in other gas companies should also exist. There is no necessary connection between manufacturing gas and buying stocks. If the purpose for which a gas company has been created is to make and sell gas, and operate gas works, the purchase of stock in other gas companies is not necessary to accomplish such purpose. The right of a corporation to invest in shares of another company cannot be implied because both companies are engaged in a similar kind of business." (1 Morawetz Priv. Corp. § 431).

### C. Mining Companies

A corporation having the right to mine, in organizing another corporation for mining purposes, acts without the scope of its powers. *McMillan*

power to purchase the stock of another corporation having a similar object to its own than it has to make such purchase in the case of a corporation formed for an entirely different purpose.

*v. Carson Hill Union Min. Co.*, 12 Phila. (Pa.) 404 (1878).

#### *D. Manufacturing Companies*

The purchase by a foreign manufacturing corporation of the stock of a domestic corporation for the purpose of controlling it, is *ultra vires*, though they are engaged in a similar business. *Marble, etc. Co. v. Harvey*, 92 Tenn. 115 (1892), (20 S. W. Rep. 427, 36 Am. St. Rep. 71, 18 L. R. A. 252). See also *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304); *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896), (31 L. R. A. 415). Manufacturing company cannot purchase stock in subsidiary manufacturing company. *People v. Pullman Car Co.*, 175 Ill. 125 (1898), (51 N. E. Rep. 664, 64 L. R. A. 366).

#### *E. Insurance Companies*

*Berry v. Yates*, 24 Barb. (N. Y.) 199 (1857); *Pierson v. McCurdy*, 33 Hun (N. Y.), 520 (1884). *Ex parte British Nation, etc. Ass'n*, L. R. 8 Ch. 679 (1878).

#### *F. Banks*

A national bank cannot hold stock in a savings bank not taken as security, or acquired in due course of business. *California Bank v. Kennedy*, 167 U. S. 362 (1897), (17 Sup. Ct. Rep. 831).

## II. CORPORATIONS OF DIFFERENT NATURE

(a) Bank cannot hold stock of railroad company: *Nassau Bank v. Jones*, 95 N. Y. 115 (1884), (47 Am. Rep. 14); nor of insurance company: *Bank of Commerce v. Hart*, 37 Neb. 197 (1893),

(55 N. W. Rep. 631, 40 Am. St. Rep. 479, 20 L. R. A. 780); nor of manufacturing company: *Franklin Co. v. Lewiston Sav. Inst.*, 68 Me. 43 (1877), (28 Am. Rep. 9).

(b) Insurance company cannot hold stock in bank. *Commercial Fire Ins. Co. v. Montgomery County*, 99 Ala. 1 (1892), (14 So. Rep. 498, 42 Am. St. Rep. 17); *State v. Butler*, 86 Tenn. 614 (1888), (8 S. W. Rep. 586).

(c) Manufacturing company cannot subscribe for or purchase stock of bank: *Sumner v. Marcy*, 3 Wood. & M. (U. S.), 105 (1847); *Hunt v. Hauser Malting Co.*, 90 Minn. 282 (1903), (96 N. W. Rep. 85); nor of railroad company: *Valley R. Co. v. Lake Erie Iron Co.*, 46 Ohio St. 44 (1888), (18 N. E. Rep. 486, 1 L. R. A. 412, 26 Am. & Eng. Corp. Cas. 56).

(d) Note-selling company cannot hold stock in bank. *Joint Stock Discount Co. v. Brown*, L. R. 8 Eq. 381 (1869).

(e) Railroad company cannot purchase stock of mining company. *Columbus, etc. R. Co. v. Burke*, 19 Ohio Week. Law Bull. 27 (1887).

(f) Furniture company cannot subscribe for stock in hotel company. *Knowles v. Sandercock*, 107 Cal. 629 (1895), (40 Pac. Rep. 1047); *Newland Hotel Co. v. Lowe Furniture Co.*, 73 Mo. App. 135 (1898).

(g) Dry dock company cannot subscribe for stock of steamship company. *New Orleans, etc. S. Co. v. Ocean Dry Dock Co.*, 28 La. Ann. 173 (1876), (26 Am. Rep. 90).

(h) Lumber company cannot subscribe for stock of telegraph company. *Peshtigo Co. v. Great Western Tel. Co.*, 50 Ill. App. 624 (1893).

(i) Land company has no author-

The underlying principle, however, is not precisely the same in both cases. A corporation cannot acquire stock in another corporation organized for similar purposes, because it must manage its funds directly through its own officers, and not indirectly by becoming a stockholder in another corporation. A corporation cannot purchase stock in another corporation created for the accomplishment of essentially different objects, not only for the reason just stated, but, primarily, because it cannot invest its funds and engage in a business entirely foreign to the purpose for which it was created. "Were this not so," said the Supreme Court of Ohio in *Franklin Bank v. Commercial Bank*,<sup>1</sup> "one corporation by buying up the majority of the shares of the stock of another, could take the entire management of its business, however foreign such business might be to that which the corporation so purchasing said shares was created to carry on. A banking corporation could become the operator of a railroad, or carry on the business of manufacturing, and any other corporation could engage in banking by obtaining the control of the bank's stock."

§ 269. **Expediency of Purchase of Stock immaterial.** — The operation of the rule that a corporation, without statutory authority, cannot subscribe for or purchase stock in another corporation is in no way affected by the fact that such purchase or subscription may be of benefit to it. An *ultra vires* agreement is not made *intra vires* by being profitable. The contract of association cannot be enlarged to take in a new adventure because the transaction seems expedient.<sup>2</sup>

In *Central, etc. R. Co. v. Collins*<sup>3</sup> the Supreme Court of Georgia said: "We do not think the profitableness of this contract, to the stockholders of the Central and Southwestern Railroad has anything to do with the matter. These stockholders have a *right*, at their pleasure, to stand on their contract. If the charters do not give to these companies the

ity to subscribe for stock of manufacturing company. *Pauly v. Coronado Beach Co.*, 56 Fed. 428 (1893).

<sup>1</sup> *Franklin Bank v. Commercial Bank*, 36 Ohio St. 355 (1881), (38 Am. Rep. 594).

<sup>2</sup> *Central, etc. R. Co. v. Collins*, 40

Ga. 582 (1869); *Valley R. Co. v. Lake Erie Iron Co.*, 46 Ohio St. 44 (1888), (18 N. E. Rep. 486, 1 L. R. A. 412, 26 Am. & Eng. Corp. Cas. 56).

<sup>3</sup> *Central, etc. R. Co. v. Collins*, 40 Ga. 617 (1869).

*right* to go into this new enterprise any one stockholder has a right to object. He is not to be forced into an enterprise not included in the charter. That it will be to his interest is no excuse; that is for him to judge."

§ 270. **Assumption of Power to hold Stock in Articles of Association.** — A stream can rise no higher than its source. The powers of corporations organized under general incorporation acts can be such only as are mentioned in those acts. The power to hold stock in other corporations exists only when granted by legislative authority. Unless such power is specifically conferred upon corporations formed under general laws, incorporators take nothing by assuming to themselves the power in their articles of association. Even the incidental powers of a corporation are not increased by such an assumption.<sup>1</sup>

In *People v. Chicago Gas Trust Co.*,<sup>2</sup> Judge Magruder said: "To hold that they (the incorporators) could confer such power by writing it down in the statement would be to hold that the general assembly could clothe them with a part of its legislative functions."

<sup>1</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497). Compare *Market St. R. Co. v. Hellman*, 109 Cal. 590 (1895), (42 Pac. Rep. 225).

In *Parsons v. Tacoma Smelting, etc. Co.*, 25 Wash. 508 (1901), (65 Pac. Rep. 765) the Supreme Court of Washington said: "It was determined by this Court in *Denny Hotel Co. v. Schram*, 6 Wash. 134 (1893), (32 Pac. Rep. 1002, 36 Am. St. Rep. 137), that a corporation could not subscribe for the capital stock of another. Our statutes cannot be said to authorize such ownership of stock any more than the authority to subscribe for capital stock. The expression of such power in the articles of incorporation of the new

company, as has been observed, cannot extend the corporate powers beyond those expressed in the statutes."

Articles of association are construed strictly against the grantee and in favor of the public, and any provisions added to the articles not authorized by the incorporation act are wholly void.

*Oregon R., etc. Co. v. Oregonian R. Co.*, 130 U. S. 1 (1889), (9 Sup. Ct. Rep. 409); *Medical College Case*, 3 Whart. (Pa.) 445 (1838); *Eastern Plank R. Co. v. Vaughan*, 14 N. Y. 546 (1856); *Heck v. McEven*, 12 Lea (Tenn.), 97 (1883).

<sup>2</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 287 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497).



II. *Express Power to acquire Stock*

§ 271. Corporations may acquire Stock in other Corporations when authorized. **Statutory Provisions.** — The statutes of the different States authorizing corporations to acquire stock in other corporations are collected in the footnote.<sup>1</sup>

<sup>1</sup> *Alabama.* Civil Code 1907, § 3640: "Any corporation . . . of any other State or Territory of the United States, or any foreign country, or territory, . . . is hereby authorized . . . to acquire, by subscription to the capital stock, or by purchase, or otherwise, and to hold, own and vote shares of the capital stock of any corporation . . . of the State of Alabama" — provided that such foreign corporation has power under its charter, etc., to acquire stock in other corporations.

*Ib.* § 3496 authorizes railroad companies to subscribe for stock in aid of construction of connecting roads.

*Arizona.* R. S. 1901, par. 864, p. 336: "Any railroad company now or hereafter existing under the laws of this Territory . . . may buy the stock and bonds . . . of any" foreign or domestic corporation.

*Arkansas.* Kirby's Digest, 1904, § 6742: "Any railroad company in this State . . . may buy . . . the stock . . . of any railroad company or companies incorporated or organized within or without this State whenever the roads of such companies shall form, in the operation thereof, a continuous line or lines."

*Ib.* § 6743: "Any railroad company . . . of any other State or Territory may . . . buy the stock . . . of any railroad company . . . of this State, whenever the roads of such companies shall form in the operation thereof a continuous line or lines." See also *ib.* § 6328.

*Colorado.* Mills' Anno. Stat. 1905,

§ 612a: "Any railroad company . . . of this State may . . . acquire and may hold the . . . stock of other companies owning or operating any" railroad which shall connect with the "line of road which such company is . . . authorized to purchase, or which, under the laws of this State, it is authorized to lease, or . . . consolidate" with.

*Connecticut.* Pub. Laws. 1903, ch. 194, § 11: "Any corporation not prohibited by any provision in its charter, articles of association, or certificate of incorporation or by any general law, except a bank, trust company, or life insurance company, may acquire, purchase, and hold the stock or securities of any other corporation."

*Delaware.* Laws 1903, ch. 394, p. 822, § 135: "Any corporation . . . of this State . . . may . . . purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of, the shares of the capital stock of . . . any other corporation or corporations of this State, or any State, country, nation or government, and while owner of said stock may exercise all the rights, powers and privileges of ownership including the right to vote thereon."

*Florida.* Gen. Stat. 1906, § 2812: "Any railroad or canal company in this State shall have power . . . to purchase the stock . . . of any other company."

*Georgia.* For Georgia constitutional provision against corporate stockholding, see *ante*, § 32, *note*.

*Idaho.* R. S., § 2686 (as amended by Sess. Laws, 1899, p. 11): "Any

The effect of these statutes is to enlarge the powers of the corporations to which they apply. There is nothing in the

railroad corporation, whether . . . of this State or of the Territory of Idaho, or of the United States, or of any other State or Territory, may take, purchase, hold, sell, and dispose of . . . the bonds and securities of any other railroad corporation whose line of railroad is continuous of or otherwise connected with its own."

*Illinois.* R. S. 1906, p. 542: "Any corporation . . . of this State for mining or manufacturing purposes . . . is hereby authorized to own and hold shares of the capital stock of any railroad company or companies when such railroad or railroads shall connect the different plants of such mining and manufacturing companies with each other, or with the other railroad or harbors. Provided, that said mining or manufacturing companies shall not . . . hold stock in more than one railroad connecting the same points."

*Indiana.* Horner's Anno. Stat. 1901, § 4013: "Any railroad company in this State and organized under the . . . laws of this State" may "subscribe and take stock in any railroad bridge company on the route of said railroad or at the terminus of said railroad, for the use and benefit of said road."

For *Indiana* statutes relating especially to gas light and water works companies, see Stat. 1894, §§ 5059 and 5087.

*Iowa.* Code 1897, § 2047: "Any railway corporation . . . of this State, or operating a road therein, under the authority of the laws thereof, may acquire, own and hold either the whole or any part of the stock . . . of any other railroad company of this or any adjoining State."

*Kansas.* Gen. Stat. 1905, § 6308:

"Any railroad company . . . of this State" may "purchase and hold the stock and bonds, or either, . . . of any other railroad company or companies, the line of whose railroad, constructed or being constructed, connects with its own."

*Kentucky.* Stat. 1903, § 769, amending Stat. 1899: "Any railroad company . . . may, unless prohibited by law, subscribe to the capital stock of any other railroad company . . . of this or any other State, with the assent of such company; and any company of this or any other State may, unless prohibited by law, subscribe to the capital stock of any company . . . of this State with the assent of such company."

*Maine.* Rev. Stat. 1903, p. 513, § 17: "A railroad corporation, which has a lease of, or which operates the railroad of another railroad corporation, may purchase and hold shares of the capital stock of such corporation."

*Ib.* § 18: "A railroad corporation, which owns a majority of the capital stock of another railroad corporation, may purchase and hold additional shares of the capital stock of such corporation."

Laws 1901, ch. 229, § 14 ("Business corporations"): "Any corporation organized under chapter forty-eight of the revised statutes may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of this or any other State, territory or country, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon."

*Maryland.* Pub. Gen. Laws, vol.

nature of a corporation which renders it incapable of holding stock in other corporations and questions of public policy are determined by the legislature in granting the power.

1, p. 658, § 282: "Any railroad company . . . of this State" may "acquire, own and hold, pledge, sell or otherwise dispose of . . . stocks, . . . of other railroad companies of this or any other State, and of any inland, coast or ocean transportation company or companies."

*Massachusetts.* Rev. Laws 1902, ch. 111, § 77: "No railroad company unless authorized by the general court or by the provisions of the following five sections, shall . . . subscribe for, take, or hold the stock or bonds of any other corporation."

*Ib.* § 78, authorizes a railroad company to hold stock to a limited amount in a telegraph company whose line connects two or more places on its railroad.

*Ib.* § 82, authorizes a railroad company to subscribe for a limited amount of stock to aid in the construction of a branch or connecting railroad.

*Ib.* ch. 110, § 79, authorizes manufacturing companies, under certain conditions, to hold stock in gas companies.

*Michigan.* Comp. Laws 1897, § 6253: "Any railroad company organized under this act may . . . subscribe to the capital stock of any other company organized under this act with the assent of such other company; and any railroad company . . . of this State may subscribe to the capital stock of any company organized under this act" not having the same terminal points and not being a competing line, with the assent of the company for whose stock such subscription is made.

*Ib.* § 6327, authorizes a railroad company to aid in the construction of another railroad by subscribing for stock.

*Ib.* § 6691 (as amended by laws

1899, pp. 18-19), authorizes telephone and messenger service corporations to purchase stock in certain other corporations.

*Ib.* § 6474, authorizes the purchase of stock in stage companies.

*Ib.* § 7011, as amended by laws 1905, p. 153, § 21, authorizes mining companies to subscribe for or purchase stock in companies furnishing transportation facilities to their mines, or power or light to be used in their works.

*Ib.* § 7012, authorizes mining companies conducting their business outside of Michigan to subscribe for and own stock in similar corporations, likewise doing business outside the State.

*Ib.* § 8516, authorizes the holding of stock in water companies.

*Minnesota.* Rev. Laws 1905, § 3071: "Every such [mining] corporation may acquire and hold stock in any other corporation, if a majority of the stockholders agree thereto."

*Ib.* § 2900, authorizes a domestic railroad company to aid any other railroad corporation in the construction of its road, by subscription to its capital stock or otherwise, for the purpose of forming a connection, or it may lease or purchase any part or all of such connecting road, not parallel, or two such roads may enter into arrangement for their common benefit; consistent with and calculated to promote the objects of their organization.

*Mississippi.* Code 1906, § 5004: "No corporation shall, directly or indirectly, purchase, or own the capital stock, or any part thereof, of any other corporation."

*Missouri.* Anno. Stat. 1906, § 1061: "Any railroad company . . . organized under the laws of this

It will be observed that the greater number of statutes apply only to railroad companies, and that these are limited

State . . . may acquire any line of railroad, within or without this State, which shall form a continuous line with the road operated by such company . . . and may acquire and may hold the obligations and stock of other companies owning or operating any such lines of road."

*Ib.* § 1060, authorizes subscriptions in aid of the construction of connecting lines.

*Ib.* § 1181, authorizes bridge companies to acquire stock in certain street railway companies.

*Montana.* Code 1895, § 912: "Any railroad corporation whose line is wholly or partly within this State, or reaches the boundary line thereof, . . . of Montana or of the United States, or of any other State or Territory, may take, purchase, hold, sell and dispose of, or guaranty the capital stock . . . of any other railroad corporation whose line of railroad within this State is continuous of or connects with its own line."

*Ib.* § 923, authorizes subscriptions and purchases of stock in aid of the construction of other railroads.

Gen. Laws 1905, ch. 103, p. 226, prescribe a method for authorizing, by a vote of two-thirds of the stock of the vendor corporation, the sale of corporate assets for stock in another corporation.

*Nebraska.* Comp. Stat. 1907, § 2028, authorizes a railroad company to aid in the construction of a connecting road by a subscription to its stock.

*Nevada.* Stats. 1905, ch. 51, § 110: "Any corporation organized under the laws of this State . . . may guaranty, purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidence of indebtedness

created by, any other corporation or corporations of this State, or any other State, country, nation or government, and which owner of said stock may exercise all the rights, powers and privileges of ownership including the right to vote thereon."

*New Jersey.* General Corporation Act of 1896, § 50: "Corporations having for their object the building, constructing or repairing of railroads, water, gas or electric works, tunnels, bridges, viaducts, canals, hotels, wharves, piers or any like works of internal improvement or public use or utility, may subscribe for, take, pay for, hold, use and dispose of stock or bonds in any corporation formed for the purpose of constructing, maintaining and operating any such public works; and the directors of any such corporation formed for the purpose of constructing, maintaining and operating any public work of the description aforesaid may accept in payment of any such subscription, or purchase, real or personal property, necessary for the purposes of such corporation, or work, labor and services performed or materials furnished to or for such corporation to the amount of the value thereof, and from time to time issue upon any such subscription or purchase, in such instalments or proportions as such directors may agree upon, full-paid stock in full or partial performance of the whole or any part of such subscription or purchase, and the stock so issued shall be full-paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payments, and in all statements and reports of the corporation to be published or filed this stock shall not be stated or reported as being issued for cash paid to the corporation, but shall

in their application to companies owning connecting lines. These railroad statutes, like similar statutes authorizing the

be reported in this respect according to the fact."

*Ib.* § 51: "Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidence of indebtedness created by any other corporation or corporations of this or any other State, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon."

*New Mexico.* Comp. Laws 1897, § 3891, authorizes railroad companies to subscribe for stock in aid of the construction of connecting roads.

*New York.* Laws 1902, ch. 601 (as amended to 1907), Art. 3, § 40 (Stock Corporation Law): "... Any stock corporation, domestic or foreign, may purchase, acquire, hold and dispose of the stocks, . . . of any corporation, domestic or foreign, and issue in exchange therefor its stock . . . if authorized so to do by a provision in the certificate of incorporation of such stock corporation, or any certificate amendatory thereof or supplementary thereto, filed in pursuance of law, or if the corporation whose stock is so purchased, acquired, held or disposed of, is engaged in a business similar to that of such stock corporation, or engaged in the manufacture, use or sale of the property, or in the construction or operation of works necessary or useful in the business of such stock corporation, or in which or in connection with which, the manufactured articles, product or property of such stock corporation are or may be used, or is a corporation with which such stock corporation is or may be authorized to consolidate. When any such corporation shall be

a stockholder in any other corporation as herein provided, its president or other officers shall be eligible to the office of director of such corporation, the same as if they were individually stockholders therein, and the corporation holding such stock shall possess and exercise in respect thereof, all the rights, powers and privileges of individual owners or holders of such stock."

Railroad Law, § 79 (Birdseye's, 1901): "Any railroad corporation . . . of this State . . . being the lessee of the road of any other railroad corporation, may take a surrender or transfer of the capital stock of the stockholders, or any of them, in the corporation whose road is held under lease, and issue in exchange therefor the like additional amount of its own capital stock at par; and whenever the greater part of the capital stock of any such corporation shall have been so surrendered or transferred, the directors of the corporation taking such surrender or transfer . . . become *ex-officio* the directors of the corporation whose road is held under lease, and shall manage and conduct the affairs thereof . . . and when the whole of such capital stock has been so surrendered or transferred, and a certificate thereof filed in the office of the Secretary of State . . . the estate . . . and franchises of the corporation whose stock shall have been so surrendered or transferred shall . . . vest in . . . the corporation to whom such surrender or transfer is made. . . . Where stock shall have been so surrendered or transferred, the existing liabilities of the corporation, and the rights of the creditors and of any stockholder not surrendering or transferring his stock, shall not be affected thereby."

consolidation of companies owning, and the purchase and lease of, continuous lines of railroad, are all indicative of the policy

*North Carolina.* Rev. Laws 1905, ch. 61, § 2567: "Any railroad or other transportation company may acquire and hold, or guaranty or indorse the bonds or stocks of . . . any railroad or branch railroad, or other transportation line in this or an adjoining State connecting with it directly or indirectly."

Pub. Laws 1901, ch. 2, § 55, p. 28 (same as *New Jersey Corp. Act* 1896, § 51, *supra*).

*Ohio.* Bates' Anno. Stat. (1787-1906), § 3300, authorizes railroad companies to subscribe for stock in aid of a connecting, but not competing, road. *Ib.* § 3546, authorizes railroad companies to subscribe for the stock of certain bridge companies. *Ib.* §§ 3631-8, authorizes certain stock subscriptions by benevolent companies; *ib.* § 3842, by elevator companies; *ib.* § 3863, by "mineral and vegetable mining and boring companies."

*Pennsylvania.* Gen. Laws. 1894, § 132: "Any and all companies incorporated or organized under the laws of this Commonwealth, . . . and . . . the directors, managers, or trustees thereof, with the approval of the stockholders," may "invest the surplus or other funds or earnings of such companies in . . . ; good stock or securities and" may "sell and transfer the same, and" may "reinvest the proceeds of such sales in . . . stocks of like kind and" may "prescribe, by resolution of the directors, or the by-laws of the company, or otherwise, the mode of making such investments, purchases and sales, with the approval of the stockholders."

Laws 1901, p. 62, Act No. 28: "Any railroad or other transportation corporation, of this Commonwealth," may "from time to time . . . acquire, own and hold, pledge, sell

or otherwise dispose of, the stock . . . and guaranty the stock . . . of any other corporation of this Commonwealth or elsewhere, engaged in the business of transportation, either on land or water, and also of any other warehouse, storage elevator or terminal company, whose business is incidental to the business of transportation in which the purchasing or guarantying corporation shall be authorized to engage."

For other *Pennsylvania* statutes authorizing the purchase of stock by railroad companies see Bright. *Purd. Dig.* 1894, §§ 156, 167, 168 and 182. For provisions relating to the purchase of stock by manufacturing or water companies, see Gen. Laws 1894, ch. 5, § 44. For provisions authorizing corporate purchase of stock of iron and steel companies, see *ib.* title "Iron and Steel Companies," § 7. See also *ib.* ch. 15, § 129, for provisions as to stock of a particular steamship company.

*South Carolina.* Code of Laws 1902, § 2061: "No corporation . . . owning or operating . . . any railroad lying, in whole or in part, within this State, or owning . . . a majority of the stock of the corporation owning or controlling . . . any such railroad, shall own or be interested in the stock of any corporation chartered by this State which owns or leases . . . any railroad which competes . . . with" such other railroad.

*Ib.* § 2060: "Railroad companies . . . of this State may . . . purchase and hold the stock . . . of other railroad companies chartered by or whose roads are authorized to extend into this State. . . . And any railroad corporation . . . of this State may guaranty the stocks and bonds . . . of any other railroad corporation, whenever the roads of such

of affording facilities for the uniting of short connecting roads into the through line.

corporations shall connect with each other, or shall form a continuous line, directly or by means of any connecting railroad, or by steamboat line . . . upon such terms and conditions as may be agreed upon by the stockholders."

*South Dakota.* Rev. Code 1903, § 494, p. 649, authorizes a railroad company to subscribe for stock in aid of the construction of another railroad.

*Texas.* Sayles' Civil Stat., ch. 16a, § 744b: "Railway companies existing under the laws of this State . . . and railway companies . . . of the United States, are authorized . . . to subscribe to the stock and purchase and own stock . . . of any depot company formed under authority of this chapter."

*Utah.* Laws 1907, ch. 93, sub. 8, p. 107: "Any railroad corporation . . . of this State . . . shall have power . . . to acquire, own, maintain, operate and navigate steamships, sailing-vessels and boats of every description, and generally to carry on the business of a common carrier by water, and to purchase, own, hold, pledge or otherwise dispose of the capital stock, bonds or other obligations of any corporation owning or operating any such ships, vessels or boats; Provided, that this section shall not be construed to permit any railroad company to purchase, own, hold, pledge, or otherwise dispose of the capital stock, bonds or other obligations of any corporation owning or operating such ships, vessels, or boats where such corporation may be a competing line with such railroad company, or with any other corporation in which said railroad company may own any of the capital stock, bonds or other obligations thereof."

*Vermont.* Pub. Stat. 1906, § 4344:

"No railroad company shall subscribe for, take, or hold, directly or indirectly, stock . . . of a railroad corporation organized under this chapter, unless specially authorized by the general assembly."

*Virginia.* Code 1904, § 1105e: (1) "Every corporation of this State shall have power: . . . If authorized so to do in its charter, certificate of incorporation, or articles of association, or in any amendment thereof, to subscribe to, purchase, or otherwise acquire, or to guaranty or to become surety in respect to the stock, bonds, or other securities and obligations of other companies."

*Washington.* Laws 1905, p. 51, ch. 27: "Any corporation . . . of this . . . or any other State . . . doing business in this State shall have power . . . to subscribe for, acquire by purchase or otherwise, and to own, hold, sell, assign and transfer shares of the capital stock of any other corporation . . . and to vote such shares at . . . meetings."

*West Virginia.* Code 1899, ch. 52, p. 538 (Gen. Corp. Law), § 3: "No corporation shall . . . subscribe for or purchase the stocks . . . of any joint stock company."

*Ib.* § 4: "Any manufacturing company may with the assent of the holders of two-thirds of its stock, . . . subscribe for or purchase the stock . . . of any corporation formed for the purpose of manufacturing . . . any articles or materials manufactured . . . by such joint stock company, or constructing a railroad . . . through or into the county in which the principal place of business of such joint stock company may be, or operating a railroad or other work of internal improvement." Any corporation may take stocks in payment of a debt owing it, etc.

The policy of the States, in general, as indicated, positively, in their legislative enactments, and negatively, in their failure to grant authority at all, has always been opposed to unlimited corporate stockholding. New Jersey and Delaware, however, have been the conspicuous exceptions to the rule. In these States, the broadest possible power is conferred upon domestic corporations to "purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of" the shares of foreign and domestic corporations and "to exercise all rights, powers and privileges of ownership, including the right to vote thereon."

At the present time the tendency seems to be toward an extension of the power of corporations to hold shares in other corporations. Broad statutes along the lines of those of New Jersey and Delaware have been enacted in several States. In other States, statutes authorizing limited corporate stockholding have been widened in their scope. This tendency is in the right direction. Holding stocks to prevent competition is against public policy. But with this and other appropriate limitations, the general powers of the modern business instrument — the corporation — should approximate those of the individual. The occasions for corporate stockholding have increased with the increase of corporations. Statutes granting

*Ib.* ch. 53, § 3, p. 544 (stock company law), is the same as § 4, ch. 52, *supra*.

*Wisconsin.* R. S. 1889, ch. 36, § 1775, authorizes certain classes of corporations to purchase and hold stock in other corporations of the same or similar nature "upon the assent of the holders of three-fourths of the capital stock of both the corporation proposing to take such stock and the corporation in which it is proposed to be taken." Laws 1899, ch. 191, amending § 1833, Stat. 1898, authorizes the purchase, by railroad companies, of stock in connecting roads or in companies to which they have furnished aid for the construction of their roads.

Stat. 1898, § 1862a, authorizes street railway companies to purchase

and take the stock of other street railway or any electrical companies.

*Wyoming.* R. S. 1899, § 3040 (Gen. Corp. Law): "It shall not be lawful for such company to use any of its funds in the purchase of any stock in any other company . . .; provided, however, such company may, in its discretion, purchase, hold and own any stock, and to any amount, in any other company that is or may be subsidiary or tributary to, and that does contribute to the objects and purposes of the first company in this proviso mentioned."

*Ib.* §§ 3205 and 3206, authorize railroad companies to subscribe for stock in aid of the construction of other roads.



and defining the power to hold stock cannot but be regarded as desirable.

§ 272. **Power to subscribe for Stock in Foreign Corporations.**—The principle has been laid down that, conceding that corporations may subscribe for stock in other corporations of the same nature governed by the same laws, such power cannot be exercised where the two corporations exist under different laws of different States, and where the law governing the corporation in which stock is taken fails to impose liabilities and create obligations imposed upon the subscribing corporation.<sup>1</sup>

The distinction, however, cannot stand the test of analysis. There is no incidental power to subscribe for stock. If such an express power exists, the question whether it is broad enough to permit a subscription for stock in a foreign corporation is entirely a question of the construction of the particular statute. The argument that a subscription for stock in a foreign corporation is *ultra vires* because the subscribing corporation thereby incurs less liabilities than in the case of a subscription to a domestic corporation is not convincing.

A manufacturing corporation authorized to hold stock has power, as incidental to its business, to organize subsidiary companies in different States for the handling and distribution of its products, of which it holds all the shares. The exercise of such power is, however, subject to the limitation that it

<sup>1</sup> *Merz Capsule Co. v. U. S. Capsule Co.*, 67 Fed. 417 (1895), (*affirmed sub nom. McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896)): "The general rule may be stated to be that it is incompetent for a corporation to subscribe for stock in another corporation. It must be acknowledged that there are exceptions to this rule, founded upon a variety of peculiar circumstances, which it is not necessary here to enumerate. I am unable to discover any ground upon which this case can be held within any of such exemptions. But, however this may be, if the corporation in which the stock is taken is a domestic one,

and subject to the same laws and dominion as the one taking such stock, or where, if the corporations are organized in different States, they are subject to regulations of a substantially identical character, my opinion is that where, as in this case, the law of the corporation in which the stock is taken is of a substantially different character, and fails to impose the liabilities and create the obligations imposed by the law of the corporation subscribing for the stock, such subscriptions are *ultra vires* of the latter corporation, and are illegal and void."

cannot organize such companies in States, the laws or policy of which are opposed to corporate stockholding.<sup>1</sup>

§ 273. **Construction of Statutes.** — Statutes authorizing corporations to acquire and hold the shares of other corporations constitute grants of power and require a reasonably strict construction.

A statute authorizing a corporation to "purchase" the shares of other corporations does not confer power to subscribe for the stock of such corporations.<sup>2</sup> Similarly, power conferred upon a corporation to "invest" its money in stocks

<sup>1</sup> *Dittman v. Distilling Co.*, 64 N. J. Eq. 537 (1903), (54 Atl. Rep. 576): "No question is or can be raised as to the power of purchasing stocks of existing companies for the purpose of accomplishing the distribution of the product; and, in my judgment, the organization of subsidiary companies for the same purpose and with the same object may be fairly and reasonably regarded as incidental to or consequential upon the business which is expressly authorized, and convenient for the attainment of its objects and should not by a judicial construction be held to be *ultra vires*. As to companies in which New Jersey companies may hold stock and the States in which subsidiary companies may be organized it may be that the late decision in *Coler v. Tacoma R. Co.*, 65 N. J. Eq. 347 (1903), (54 Atl. Rep. 413) limits the power of New Jersey companies to hold stock of corporations of other States to the holding of stock in companies organized in States whose laws authorize their own domestic corporations to hold stock in, and control, their own domestic companies."

See also *post*, § 286: "*Rights of Foreign Corporation holding Stock.*"

<sup>2</sup> *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673 (1903), (53 Atl. Rep. 847): "In my opinion the word 'purchase' is not used in the broad sense of the word 'acquire' but in the more usual and proper sense which makes

it the correlative of the word 'sell.'"

Subscribing for new stock is a very different thing from buying or purchasing stock which has already been issued, and is held against the corporation which issued it. Subscribing for an original issue of stock at the formation of a corporation, or for a new issue made by an existing corporation, is an act in the nature of a loan. It is a direct contribution of capital to a corporation. The distinction between subscribing for or taking new stock from a corporation and purchasing outstanding stock, is analogous to one so often drawn by the law between a loan of money to a party who gives a promissory note with an indorser as security and the purchase of exactly the same note after it has once been lawfully and honestly issued. Neither by the purchase of outstanding stock nor by the purchase of outstanding promissory notes is the party obligor who issued the stock or notes directly affected."

See also *Martin v. Stove Co.*, 78 Ill. App. 105 (1898).

A manufacturing corporation having power to purchase the stocks of other corporations may organize corporations in different States for the distribution of its products and may hold the shares of such corporations.

*Dittman v. Distilling Co.*, 64 N. J. Eq. 537 (1903), (54 Atl. Rep. 570).

does not authorize it to subscribe for stock in a projected corporation;<sup>1</sup> and, conversely, authority to subscribe does not confer power to purchase.<sup>2</sup> So, a statute<sup>3</sup> authorizing a railroad company to aid another in the construction of its road, by subscribing for its stock, does not authorize the purchase of the stock of a completed road.<sup>4</sup>

A statute authorizing a trust company "to buy and sell all kinds of government, State, municipal and other bonds, and all kinds of negotiable and non-negotiable paper, stocks and

<sup>1</sup> In *Commercial Fire Ins. Co. v. Montgomery County*, 99 Ala. 1 (1891), (14 So. Rep. 490, 42 Am. St. Rep. 17), it was held that the provision of the Alabama Code (Code 1886, § 1535), authorizing incorporated insurance companies to "invest their money in real and personal property, stocks, or choses in action," did not authorize such a company to subscribe for stock in a corporation in process of formation. See also *McAlister Mfg. Co. v. Florence Cotton, etc. Co.*, 128 Ala. 240 (1901), (30 So. Rep. 632).

Where a corporation was organized for manufacturing purposes, with power to invest in the shares of other corporations, it was held that such authorization did not confer power to change another corporation, having a small capital in which it held the majority of the stock, into a holding corporation with a capital a hundred times its original capital, for the purpose of acquiring stocks in other corporations.

*Robinson v. Holbrook*, 148 Fed. 107 (1906). In this case the Court said (p. 111): "The power to invest in shares of other corporations must, however, be regarded as incidental to the charter purposes of the Gorham Company; i.e. 'manufacturing goods made of gold, silver, or other metallic substance, and for the transaction of other business connected therewith.' The incidental power to invest granted by amendments to the charter is to be narrowly construed,

being in derogation to the ordinary rule that one corporation cannot invest in shares of stock of another. It would involve great practical difficulties were we to hold that the power to invest in shares of other corporations can be construed as an unlimited power to initiate or to promote new enterprises different in character and scope, perhaps exceeding in magnitude, that for which original charter powers were granted. It seems probable that the power of holding shares is a subordinate power, not to be so exercised as to enlarge the general scope of the business of the corporation by promoting other distinct corporate enterprises, whether in a different field or in the same field. It is very doubtful whether, by giving the Gorham Company power to invest in the shares of other corporations, the Legislature intended to confer the power to set up and practically create a new corporation in the same line of business which should control its creator."

<sup>2</sup> A purchase by one railroad corporation of shares in another company is not authorized by a charter provision conferring power to subscribe for and hold shares in such company. *Whitman v. Watkin (Ch.)*, 78 Law T. Rep. 188 (1897.)

<sup>3</sup> *Ohio Rev. St.* § 3300.

<sup>4</sup> *Columbus, etc. R. Co. v. Burke (Com. Pl.)*, 19 Weekly Law Bull. 27 (1887). Compare *Baltimore v. Baltimore, etc. R. Co.*, 21 Md. 50 (1863).

other investment securities," does not confer power upon such a company to purchase all the stock of another corporation for the purpose of controlling its management.<sup>1</sup>

A statute<sup>2</sup> authorizing a railroad company to purchase the stock of another railroad corporation, of which it is lessee, does not restrict the application of a general statute<sup>3</sup> authorizing corporations, including railroad companies, to purchase and hold stock in other corporations engaged in a similar business.<sup>4</sup>

Authority to organize corporations "for any lawful purpose," contained in a general incorporation act, has been held not to authorize the formation of a corporation for the express purpose of acquiring and holding stock in other corporations.<sup>5</sup>

<sup>1</sup> *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721 (1904). In this case the Court said (p. 736): "The only authority of the Missouri Company to purchase stock in another corporation is found in subdivision 9, § 2839, Rev. St. Mo. 1889, which reads: 'To buy and sell all kinds of government, State, municipal and other bonds, and all kinds of negotiable and non-negotiable paper, stocks and other investment securities.' The context shows very clearly that the purpose was not to authorize the purchase of all of the stock of another company for the purpose of controlling its management, but to authorize the buying and selling of stocks as investment securities, in like manner as government bonds and the other securities named are bought and sold. Controlling the management of a corporation of another State through the ownership of its entire stock is not buying or selling investment securities, nor is it fairly incidental thereto. The hazards of such a venture are altogether repugnant to the purposes for which the Missouri Company was formed, which included the handling and investing of the money of others, executing trusts under deeds and

wills, acting as guardian of infants and insane persons, and guaranteeing the fidelity of persons holding places of public or private trust; all requiring the maintenance of a high standard of credit and stability on the part of that company."

For construction of early statute regarding investments by insurance companies in stocks of other corporations see *Verplank v. Mercantile Ins. Co.*, 1 Edw. ch. 84 (1831).

The section of the New Jersey Corporation Act of 1896, authorizing corporations to purchase the shares of other corporations does not repeal the limitations upon the powers of an insurance company prescribed by the laws of that State with respect to the investment of its funds; nor does it authorize such a company to subscribe for the stock of another corporation.

*Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673 (1903), (53 Atl. Rep. 842).

<sup>2</sup> *New York: Laws 1890*, ch. 565.

<sup>3</sup> *New York: Laws 1890*, ch. 564, Art. 3, § 40.

<sup>4</sup> *Oelbermann v. New York, etc. R. Co.*, 77 Hun (N. Y.), 332 (1894), (29 N. Y. Supp. 545).

<sup>5</sup> *People v. Chicago Gas Trust Co.*,

On the other hand, a provision in the California Civil Code<sup>1</sup> authorizing the organization of private corporations "for any purpose for which individuals may lawfully associate themselves" has been held to permit the formation of a corporation for the specific purpose of purchasing, holding and selling stock in other companies.<sup>2</sup>

A statute authorizing one corporation to subscribe for or purchase stock in another corporation may be so construed as to make good a prior unauthorized acquisition.<sup>3</sup>

Authority in the charter of a banking corporation "to pur-

130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497).

<sup>1</sup> California Civil Code, § 286.

<sup>2</sup> Market St. R. Co. v. Hellman, 109 Cal. 571 (1895), (42 Pac. Rep. 225). In this case the Court said (p. 590): "It is beyond controversy that individuals may lawfully associate themselves for the purpose of purchasing, selling, and dealing in all kinds of public and private stocks, bonds, and securities. The Pacific Improvement Company, having been organized for exactly that purpose, it is *intra vires* to purchase, hold and sell stock in other corporations."

Under the earlier New Jersey statute providing that corporations may be organized for "any lawful business or purpose" and the Corporation Act of 1896 authorizing corporations organized thereunder to hold the shares of other corporations, it is held that a corporation may be organized for the express purpose of holding stock in, and controlling, other corporations.

Dittman v. Distilling Co., 64 N. J. Eq. 537 (1903), (54 Atl. Rep. 570).

In this case the Court said (p. 572): "The ownership of stock, and control of corporations by means of such ownership, by either an individual or a partnership is in general a lawful act; and the organization of a partnership for the purpose of

such ownership and control, either alone or in conjunction with other objects is unquestionably a lawful object or purpose of an association of individuals. The only theory upon which the formation of corporations for the purpose of holding stock of other corporations could be held not to be a "lawful purpose" within the meaning of the act, is that an authority to own the stock and control the management of other corporations must be given expressly and in terms in the section authorizing the formation of corporations, in order to be lawful. This power to own and control stock of other corporations is expressly given by a subsequent section to all corporations, when organized, and to the same extent as individuals. Such ownership of stock is, therefore, a lawful act. This legislative declaration as to the lawfulness of the ownership of stock by corporations precludes the courts, as it seems to me, from declaring that such ownership cannot be included within the lawful purposes for which a corporation may be formed, merely for the reason that it is not expressly and specially authorized in the section of the act defining the purposes of incorporation."

<sup>3</sup> *In re Buffalo, etc. R. Co.*, 74 N. Y. St. Rep. 345 (1896), 37 N. Y. Supp. (1048).

chase securities of any kind " does not authorize the purchase of shares of other corporations.<sup>1</sup>

A statute authorizing a manufacturing corporation to acquire stock in other corporations with which it transacts business, does not authorize the purchase of the shares of an insolvent rival corporation which has ceased to transact business, for the purpose of obtaining its patronage.<sup>2</sup>

<sup>1</sup> *Bank of Commerce v. Hart*, 37 Neb. 201 (1893), (55 N. W. Rep. 631, 40 Am. St. Rep. 479, 20 L. R. A. 780): "But there is no provision in the bank's charter which, by any reasonable construction, can be construed into an authority to purchase and hold stocks of any other corporation. True, it says 'to purchase securities of any kind,' but certificates of stock are not securities within the meaning of this provision, nor such as the word imports in commercial or banking phraseology. 'Securities,' as here used, mean notes, bills of exchange, and bonds; in other words evidences of debt, promises to pay money."

*Compare Latimer v. Citizens State Bank*, 102 Iowa, 162 (1897), (71 N. W. Rep. 225).

<sup>2</sup> *De la Vergne Refrigerating Mach. Co. v. German Sav. Inst.*, 175 U. S. 40 (1899), (20 Sup. Ct. Rep. 20).

Where a corporation has power to acquire and deal in the stocks of other corporations, it may promote a new corporation to conduct a similar business, of which it is to hold a large part of the stock, with a view of increasing its business and profits, and it is immaterial whether the stock so received be issued as fully paid or not.

*Rubino v. Pressed Steel Car Co.*, 53 Atl. Rep. 1050 (N. J. Ch. 1903).

Where a corporation, having power to purchase the shares of another corporation, made such purchase, paying for the stock acquired with its own stock upon an agreed basis, and agreed to pay in addition

a certain sum in cash in ten semi-annual payments, it was held that such purchase was not rendered *ultra vires* by the fact that the method adopted for making such payments amounted to a guaranty of dividends upon such stock.

*Strickland v. National Salt Co.*, 64 Atl. Rep. 982 (N. J. Ch. 1906).

Under the *West Virginia* statutes a corporation by the vote of sixty per cent of its stockholders may sell in good faith all of its property and accept in payment the stocks of other corporations.

*Germer v. Triple State Natural Gas, etc. Co.*, 54 S. E. Rep. 509 (W. Va. 1906).

For examination of *New Jersey* statutes and decisions concerning right of corporations to acquire and hold stocks of other corporations, see *Dittman v. Distilling Co.*, 64 N. J. Eq. 537 (1903), (54 Atl. Rep. 570).

Partnership associations organized under the laws of Pennsylvania may own stock in corporations. *Layng v. French Spring Co.*, 149 Pa. St. 308 (1892), (24 Atl. Rep. 215); *Carter v. Producers, etc. Oil Co.* (Com. Pl.), 24 Pittsb. Leg. J. (N. S.) 380 (1894).

For construction of *Kansas* statutes relating to the purchase of stock by railroad companies see *Atchison, etc. R. Co. v. Fletcher*, 35 Kan. 236 (1886), (10 Pac. Rep. 596); *Atchison, etc. R. Co. v. Cochran*, 43 Kan. 225 (1890), (23 Pac. Rep. 151, 19 Am. St. Rep. 134, 7 L. R. A. 414); *Atchison, etc. R. Co. v. Davis*, 34 Kan. 209 (1885), (8 Pac. Rep. 530). See also

A statute prohibiting the taking of stocks by a corporation except in payment of, or as security for, a debt applies only to corporations actually engaged in carrying on the business for which they were organized and is inapplicable to a corporation which is winding up its affairs.<sup>1</sup>

§ 274. **Construction of Constitutional Prohibitions.** — The holding of stock in other corporations is beyond the powers of a corporation, in the absence of statutory authority. The holding of stock in other companies, in order to prevent competition, is opposed to public policy. Constitutional prohibitions of purchases for such a purpose are, therefore, unnecessary, except as imposing limitations upon the power of the legislature to grant authority. Such provisions have, however, been adopted in several States and have been construed by the courts.

The provision in the Pennsylvania constitution<sup>2</sup> that "no railroad, canal or other corporation . . . shall . . . in any way control any other railroad or canal corporation owning, or having under its control, any parallel or competing line" is violated by an arrangement made by a railroad company to buy the stock of a competing line. Ownership of a majority of its stock constitutes the "control" of a corporation, within the meaning of the provision.<sup>3</sup>

The prohibition in the Georgia constitution<sup>4</sup> against the grant

*Kimball v. Atchison, etc. R. Co.*, 46 Fed. 888 (1891).

<sup>1</sup> *Metcalf v. American School Furniture Co.*, 122 Fed. 115 (1903).

In this case it was also held that when a corporation was authorized by its charter to dispose of its property and discontinue its existence, it had power to accept stock in another corporation in payment for its property.

For construction of *Mississippi* statute (see *ante*, § 271, *note*) prohibiting corporate stockholding see *Woodberry v. McClurg*, 78 Miss. 831 (1901), (29 So. Rep. 514).

<sup>2</sup> *Pennsylvania* Const. Art. XVII. § 4. See *ante*, § 32, *note*.

<sup>3</sup> *Pennsylvania R. Co. v. Common-*

*wealth* (Pa. 1886), (7 Atl. Rep. 371). In this case the purchasing corporation claimed that an arrangement to buy stock did not violate this constitutional provision, relying upon the remark of Chief Justice Waite in *Pullman Palace Car Co. v. Missouri Pacific R. Co.*, 115 U. S. 597 (1885), (6 Sup. Ct. Rep. 199), in speaking of a stockholding road: "Practically it may control the company, but the company alone controls the road." The Pennsylvania court, however, said that this remark was merely a different way of stating the truism that a corporation is controlled by its stockholders.

<sup>4</sup> *Georgia* Const. Art. IV. § 2, par. 4. See *ante*, § 32, *note*.

of power to one corporation to purchase the stock of any other corporation tending to defeat or lessen competition or encourage monopoly, cannot be evaded by indirection; and the fact that stock in a competing corporation is obtained in the name of its managers, but for the use of a corporation, will not prevent the application of the constitutional provision.<sup>1</sup>

The holding, by a railroad corporation, of a controlling interest in the stock of a coal mining company is not in contravention of another provision of the Pennsylvania constitution<sup>2</sup> that common carriers shall not engage in mining, or in manufacturing articles for transportation over their lines.<sup>3</sup>

A California constitutional provision forbids a corporation to engage in any business other than that expressly authorized by its charter or the law under which it is organized.<sup>4</sup> It is held that a corporation, by acquiring stock in another corporation, becomes engaged in the business of that corporation within the meaning of the prohibition.<sup>5</sup>

<sup>1</sup> *Langdon v. Branch*, 37 Fed. 449 (1888), (2 L. R. A. 120).

In *Trust Co. v. State*, 109 Ga. 736 (1899), (35 S. E. Rep. 323, 48 L. R. A. 520) it was held that this *Georgia* constitutional provision denying the General Assembly "power to authorize any corporation to buy shares of stock in any other corporation" was not an absolute denial of power and did not prevent the General Assembly from authorizing such purchases where competition was in no way affected. The Court said (p. 752): "It is further contended that under the constitution the provision in relation to corporations buying shares of stock in any other corporation has no reference whatever to the effect of such purchases upon competition or monopoly, and that they are absolutely void, although they have no tendency to defeat or lessen competition, or to

encourage monopoly. We think this is an entire misconception of this provision in the constitution. The prohibition against the legislative grant to corporations of power to buy shares of stock in another corporation is clearly qualified by that portion of the section cited which restricts such purchases only when they have the effect, or are intended to have the effect, to defeat or lessen competition in their respective businesses, or to encourage monopoly."

See also *State v. Central R., etc. Co.*, 109 Ga. 716 (1899), (35 S. E. Rep. 37).

<sup>2</sup> *Pennsylvania* Const. Art. XVII. § 5.

<sup>3</sup> *Hartwell v. Buffalo, etc. R. Co.*, 19 Pa. Co. Ct. 231 (1897).

<sup>4</sup> *California* Const. Art. XII. § 9.

<sup>5</sup> *Knowles v. Sandercock*, 107 Cal. 629 (1895), (40 Pac. Rep. 1047).



III. *Incidental Power to acquire Stock*

§ 275. **In General.** — An incidental power is one that is directly and immediately appropriate to the execution of a specific power granted, and not one that has a slight or remote relation to it.<sup>1</sup> When the purchase of stock in another corporation is reasonably necessary to the full and complete exercise of the express powers of a corporation, power to make such purchase will be implied.<sup>2</sup> Whether such power exists in a particular case will depend upon the nature of the corporation and the objects for which the stock is to be acquired.

Corporations like insurance companies, which find it necessary to keep large amounts of funds on hand, may, perhaps, without express authority, invest their surplus funds in the

<sup>1</sup> *Hood v. New York, etc. R. Co.*, 22 Conn. 16 (1852); *Franklin Co. v. Lewiston Sav. Inst.*, 68 Me. 43 (1877), (28 Am. Rep. 9); *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497).

<sup>2</sup> *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335 (1894), *affirming s. c. sub nom. Tod v. Kentucky Union Land Co.*, 57 Fed. 47 (1893). In the latter decision the Court refers at length to *Louisville, etc. R. Co. v. Literary Society of St. Rose*, 91 Ky. 395 (1891), (15 S. W. Rep. 1065), in regard to the *implied powers* of a corporation. In that case two educational corporations, having power to contract and to buy and sell real and personal property for the purpose of carrying on their institutions of learning, owned and operated large farms of considerable value. Each of these corporations subscribed a sum of money payable to a railroad company to induce it to extend its line near their property which would enhance its value. Regarding the defence of *ultra vires* to an action upon the subscriptions the Court said: "The building of the road was calculated, however, to be highly bene-

ficial to them, both as furnishing convenient access to them for persons coming and going, and also in furnishing them a means of obtaining their supplies, and sending their product to market. It was calculated to, and undoubtedly did, add greatly to the value of their properties, and the large industries which their charters had authorized them to create. It conferred a direct benefit. The power existed, by fair implication, to do anything reasonably calculated to add to this value. How far this power extended, we need not decide. Certainly, however, if, during a portion of the year, these institutions had been almost inaccessible, for the lack of a turnpike or a bridge, a subscription by them to build either would have been valid; and, while not authorized to enter into any manner of speculations, yet, in our opinion, a subscription by them to aid the building of this road was not, under all the circumstances, *ultra vires*, and, therefore, void."

For a very broad view of incidental powers in reference to the purchase of stocks see *Hill v. Nisbet*, 100 Ind. 349 (1884).

shares of dividend-paying corporations, while such a power would be denied a manufacturing company, in whose nature there is nothing which renders it proper to accumulate funds for outside investments.<sup>1</sup> But a manufacturing corporation, while without power to purchase shares in another corporation, might take them in payment of a debt.<sup>2</sup>

While an incidental power to invest funds in stocks may be implied in the case of a certain class of corporations, and a like power may be implied in the case of other corporations to take stocks in regular course of business, no such power can ever be implied to *subscribe* for shares in a new corporation and aid in the creation of a new enterprise.<sup>3</sup>

§ 276. **Incidental Power to make Investments in Stocks.** — Corporations whose objects require the investment of their capital and surplus funds for the purpose of deriving an income may, it is held, for that purpose, without express statutory authority, invest in the shares of other dividend-paying corporations.<sup>4</sup> Thus, in *Hodges v. New England Screw*

<sup>1</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497). See *post*, § 276: "*Incidental Power to make Investments in Stocks.*"

<sup>2</sup> *Post*, § 277: "*Incidental Power to take Stock in Satisfaction of Debt.*"

<sup>3</sup> *Smith v. Newark, etc. R. Co.*, 8 Ohio Cir. Ct. Rep. 583 (1894).

<sup>4</sup> *Hodges v. New England Screw Co.*, 1 R. I. 312 (1850), (53 Am. Dec. 624); s. c. 3 R. I. 9 (1853); *Talmage v. Pell*, 7 N. Y. 343 (1852); *Pearson v. Concord R. Corp.*, 62 N. H. 537 (1883), (13 Am. St. Rep. 590). In the last case the Supreme Court of New Hampshire (*per Smith, J.*) said (p. 549): "Certain classes of corporations, such as religious and charitable corporations, and corporations for literary purposes, may rightfully invest their moneys in the stocks of other corporations. The power, if not expressly mentioned in their charters, is necessarily implied, for the preservation of the funds with which such institutions are endowed,

and to render their funds productive. So, an insurance company or savings bank may rightfully invest its capital or deposits in the stocks of railroad companies, banks, manufacturing companies, and similar corporations. The power is necessary to enable them to engage in the business for which they are organized, and hence is implied, if not expressly granted, in their charters. Such investments are in the line of their business. On the other hand, a manufacturing or railroad corporation is incorporated to do the business of manufacturing, or transporting passengers and merchandise. Investing their funds in that of other corporations is not in the line of their business. Under extraordinary circumstances, it may become necessary for a national bank, or a manufacturing corporation, or a railroad corporation, to acquire stock in another corporation, as in satisfaction of a valid debt, or by way of security, but with a view to its subsequent sale or conversion into

Co.<sup>1</sup> the Supreme Court of Rhode Island said: "There are large classes of corporations in Rhode Island, and the other States, which may and do rightfully invest their capital in the stock of other corporations; such, for instance, as religious and charitable corporations, and corporations for literary and scientific purposes. So, insurance companies may rightfully invest their capital in the stock of other corporations, such as banks and railroads, and the like."

No such incidental power, however, exists in corporations generally,<sup>2</sup> and it is difficult, upon principle, to justify its existence in the class of corporations referred to.<sup>3</sup> Although such corporations have, as immediately appropriate to the exercise of their chartered powers, the right to invest their funds for the purpose of deriving an income, the field for investment is so large that it may well be denied that it is reasonably necessary to invest in the shares of other corporations and assume the responsibilities of stockholders therein.

The importance of this question is, however, minimized by the fact that, at the present time, the investments of savings banks, insurance companies and other corporations of a similar nature are generally regulated by statute.

§ 277. **Incidental Power to take Stock in Satisfaction of Debt.** — As an incident to the power to transact business, money so as to make good or redeem an anticipated loss."

<sup>1</sup> *Hodges v. New England Screw Co.*, 1 R. I. 347 (1850), (53 Am. Dec. 624); s.c. 3 R. I. 9 (1853).

<sup>2</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497); *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896), (31 L. R. A. 415); *Pearson v. Concord R. Corp.*, 62 N. H. 537 (1883), (13 Am. St. Rep. 590). See also cases cited in note to *ante*, § 264: "*Necessity for Statutory Authority to purchase Stock. Rule in United States.*"

Where a malting company without express authority purchases bank stock for investment its act is *ultra vires*.

*Hunt v. Hauser Malting Co.*, 90

Minn. 282 (1903), (96 N. W. Rep. 85).

The decision in *Smith v. Newark, etc. R. Co.*, 8 Ohio Cir. Ct. Rep. 583 (1894), that a railroad company, unless prohibited, may invest in the dividend-paying stocks of other corporations, has no foundation in principle or authority.

<sup>3</sup> In *People v. Chicago Gas Trust Co.*, 130 Ill. 283 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497), the Court said: "Some corporations, like insurance companies, may find it necessary to keep funds in hand for the payment of losses by death or fire, or to meet other necessary demands, but it is questionable whether even these can invest their surplus funds in the stocks of other corporations without special legislative authority."

enter into contracts and become a creditor, a corporation has the power to do what is necessary in order to collect debts due it, and may take title to all kinds of property, including the stock of other corporations, in payment or compromise of a debt.<sup>1</sup> The acquisition of stock for such purposes is directly appropriate to the execution of the specific powers conferred upon every banking, manufacturing and mercantile corporation.

Shares of stock may be so taken in satisfaction of a debt with a view to sell them again, although the corporation is without authority to purchase or invest its funds in such shares. In *Charlotte First National Bank v. National Exchange Bank*<sup>2</sup> Mr. Chief Justice Waite said: "Dealing in stocks is not expressly prohibited; but such a prohibition is implied from the failure to grant the power. In the honest exercise of the power to compromise a doubtful debt owing to a bank, it can hardly be doubted that stocks may be accepted in payment and satisfaction, with a view to their subsequent sale or conversion into money so as to make good or reduce an

<sup>1</sup> *Charlotte First Nat. Bank v. National Exch. Bank*, 92 U. S. 122 (1875); *Citizens State Bank v. Hawkins*, 71 Fed. 369 (1896); *Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co.*, 127 N. Y. 252 (1891), (27 N. E. Rep. 831, 24 Am. St. Rep. 448); *Talmage v. Pell*, 7 N. Y. 328 (1852); *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497); *Hodges v. New England Screw Co.*, 1 R. I. 312 (1850), (53 Am. Dec. 6241) s. c. 3 R. I. 9 (1853); *Howe v. Boston Carpet Co.*, 16 Gray (Mass.), 493 (1860); *Tourtlot v. Whithed*, 9 N. D. 407 (1900), (84 N. W. Rep. 8).

In *Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co.*, *supra*, the statute under which the corporation was organized (N. Y. Laws 1848, ch. 40, § 8) provided that "it shall not be lawful for such company to use any of their funds in the purchase of any stock in any other corporation,"

but it was held that the "funds" referred to meant the money of the corporation, and that the statute was not intended to limit the power of the corporation to take stock in payment of a debt.

Where the officers of an insurance company, without previous authorization, accepted bank stock in part payment of an indebtedness due it and the directors without knowledge of the arrangement subsequently treated the stock as part of the company's assets it was held that the act of the officers was ratified. It was also held that the taking of the stock was within the powers of an insurance company although outside the general scope of its business.

*Fidelity Ins. Co. v. German Sav. Bank*, 127 Iowa, 591 (1905), (103 N. W. Rep. 958).

<sup>2</sup> *Charlotte First Nat. Bank v. National Exch. Bank*, 92 U. S. 128 (1875).

anticipated loss. Such a transaction would not amount to a dealing in stocks."

The stock must, however, be taken, in good faith, in satisfaction of an existing debt, and such incidental power cannot be exercised as a mere device to cover an unauthorized transaction. Thus, a corporation cannot, without statutory authority, sell goods to another corporation and create a debt, with an express understanding that it is to be satisfied by the delivery of stock of the purchasing corporation.<sup>1</sup>

Upon principles similar to those just stated, a corporation, in compromising a contested claim *against* it, may pay a larger sum than would have been exacted in satisfaction of the claim, in order to obtain a transfer of stocks in other corporations in the *bona fide* belief that, by turning them into money under more favorable circumstances, it may diminish its loss.<sup>2</sup>

A corporation may levy upon shares of stock in other corporations held by its debtor, may sell the same upon execution and, if necessary, may buy them in, whenever such levy and sale would be permitted in the case of a natural person.<sup>3</sup>

<sup>1</sup> Valley R. Co. v. Lake Erie Iron Co., 46 Ohio St. 44 (1888), (18 N. E. Rep. 486, 26 Am. & Eng. Corp. Cas. 55). See also Charlotte First Nat. Bank v. National Exch. Bank, 92 U. S. 122 (1875). Compare Howe v. Boston Carpet Co., 16 Gray (Mass.), 493 (1860); Treadwell v. Salisbury Mfg. Co., 7 Gray (Mass.), 393 (1856), (66 Am. Dec. 490).

In *White v. Marquadt* (Iowa, 1897), 70 N. W. Rep. 193, the Supreme Court of Iowa held that while a corporation might not buy shares in another corporation it could take them in exchange for goods. The Court said: "If it had purchased the stock outright, as a purely business venture, it may be that the defence here interposed would prevail. But this it did not do. It received the stock while carrying on business in the usual manner, in exchange for property which it was authorized to sell. These shares were tangible property, and as no limitations were

imposed by its articles of incorporation as to the kind of property it should take in payment for the merchandise it was authorized to sell, we think it had power to accept the shares of stock in payment."

The distinction is, obviously, without foundation. It is impossible to distinguish in principle between buying with money and money's worth.

<sup>2</sup> *Charlotte First Nat. Bank v. National Exch. Bank*, 92 U. S. 122 (1875).

Where a national bank acquired an interest in a mine through an assignment of a mining company for the benefit of its creditors, it was held that it had a right to exchange such interest for stock in a new company organized to take over the mining property.

*Morgan v. King*, 27 Colo. 539 (1900), (63 Pac. Rep. 416).

<sup>3</sup> *Citizens State Bank v. Hawkins*, 71 Fed. 369 (1896).

§ 278. **Incidental Power to take Stock as Collateral.** — For the same reason that corporations possess the incidental power to take the stock of other corporations in satisfaction of a debt, they have the power to accept such stock as *security* for an existing indebtedness.<sup>1</sup>

Upon similar principles, a corporation, having the power to loan money, may, as incidental to the exercise of that power, and in the usual course of business, accept the stock of another corporation as collateral security for a present loan, although the purchase of such stock for investment purposes or otherwise may be wholly *ultra vires*. Taking stock as security does not constitute dealing in stocks.<sup>2</sup> The presumption is against any intention on the part of the lend-

<sup>1</sup> *California Bank v. Kennedy*, 167 U. S. 362 (1897), (17 Sup. Ct. Rep. 831), *reversing Kennedy v. California Savings Bank*, 101 Cal. 495 (1894), (35 Pac. Rep. 1039, 40 Am. St. Rep. 169). See also cases cited in notes to last section.

<sup>2</sup> *United States*: In *California Bank v. Kennedy*, 167 U. S. 366 (1897), (17 Sup. Ct. Rep. 831), Justice White said: "It is well settled that the United States statutes relative to national banks constitute the measure of the authority of such corporations, and that they cannot rightfully exercise any powers except those expressly granted, or which are incidental to carrying on the business for which they are established. *Logan County Bank v. Townsend*, 139 U. S. 73 (1891), (11 Sup. Ct. Rep. 496). No express power to acquire the stock of another corporation is conferred upon a national bank, but it has been held that, as incidental to the power to loan money on personal security, a bank may, in the usual course of doing such business, accept stock of another corporation as collateral, and, by the enforcement of its rights as pledgee, it may become the owner of the collateral and be subject to liability as other stockholders. *National Bank v. Case*,

99 U. S. 628 (1878). So, also, a national bank may be conceded to possess the incidental power of accepting in good faith stock of another corporation as security for a previous indebtedness. It is clear, however, that a national bank does not possess the power to deal in stocks. The prohibition is implied from the failure to grant the power. *Charlotte First Nat. Bank v. National Exch. Bank*, 92 U. S. 128 (1875)."

See also *Citizens State Bank v. Hawkins*, 71 Fed. 369 (1896); *County Court v. Baltimore, etc. R. Co.*, 35 Fed. 161 (1888); *Shoemaker v. National Mech. Bank*, 1 Hughes, 101 (1869), (21 Fed. Cas. 1331).

*Iowa*: *Calumet Paper Co. v. Stotts Invest. Co.*, 96 Iowa, 147 (1895), (64 N. W. Rep. 782, 59 Am. St. Rep. 362).

*Minnesota*: *Baldwin v. Canfield*, 26 Minn. 43 (1879), (1 N. W. Rep. 261).

*New York*: *Talmage v. Pell*, 7 N. Y. 328 (1852); *Milbank v. New York, etc. R. Co.*, 64 How. Pr. 20 (1882).

*Ohio*: *Contra, Franklin Bank v. Commercial Bank*, 36 Ohio St. 350 (1881), (38 Am. Rep. 594).

*England*: *Royal Bank of India's Case*, L. R. 4 Ch. App. 252 (1869).

ing corporation to become the owner of the stock pledged as collateral.<sup>1</sup>

Corporations acquiring stock as collateral have all the rights of natural persons to make the security available, and, in enforcing their rights as pledgees, may become the owners of the collateral.<sup>2</sup>

§ 279. **Incidental Power to acquire Stock in Connection with Consolidation or Purchase.** — A corporation having power to consolidate with another, may, for the purpose of effecting consolidation, purchase the stock of such other corporation whenever such purchase is reasonably necessary as a means to that end. Power to make such purchase will be implied from the broader power to consolidate.<sup>3</sup> In *Louisville Trust Co. v. Louisville, etc. R. Co.*<sup>4</sup> Judge Taft said: "It is true that, ordinarily, one corporation has no power to acquire

<sup>1</sup> *Robinson v. Southern Nat. Bank*, 180 U. S. 309 (1900), (21 Sup. Ct. Rep. 383).

<sup>2</sup> *California Bank v. Kennedy*, 167 U. S. 366 (1897), (17 Sup. Ct. Rep. 831); *National Bank v. Case*, 99 U. S. 628 (1878); *Latimer v. Citizens State Bank*, 102 Iowa, 162 (1897), (71 N. W. Rep. 225); *Talmage v. Pell*, 7 N. Y. 728 (1852). In the *Royal Bank of India's Case*, L. R. 4 Ch. App. 252 (1869), it was said that the bank having advanced money upon the security of certain shares, the directors were justified in doing "anything which was a prudent and proper act for them to do with a view to obtaining the benefit of such security."

<sup>3</sup> *Louisville Trust Co. v. Louisville, etc. R. Co.*, 75 Fed. 433 (1896); *Hill v. Nisbet*, 100 Ind. 341 (1885); *Ryan v. Leavenworth, etc. R. Co.*, 21 Kan. 365 (1879), *Wall v. London, etc. Assets Corp.*, 2 Ch. 469 (1898), (67 L. J. Ch. 596, 79 L. T. (N. S.) 249, 47 W. R. 219).

A land company empowered to form a "temporary or permanent consolidation" with any railway company, in furtherance of its general powers may purchase all the

stock of a railway company, and thereby control the same, if such control is a furtherance of the general powers of the land company. *Tod v. Kentucky Union Land Co.*, 57 Fed. 47 (1893), *affirmed sub nom. Marbury v. Kentucky Union Land Co.*, 62 Fed. 335 (1894), where, in deciding the appeal, Judge Taft said: "The cases last cited are all of them stronger cases than the one at bar, for in all of them the courts were obliged by construction to go outside and permit the investment of the property of the company in a business not expressly authorized by the charter. Here we keep within the letter of the charter, for here the company has the right to embark its entire capital and risk it all by consolidation with a railway company in the business of building and running a railroad, and we only hold that, having such power, it has the right to do less than that, and risk only a part of its funds by lending its credit to such a railway company, and retaining control of it by owning its entire stock."

<sup>4</sup> *Louisville Trust Co. v. Louisville, etc. R. Co.*, 75 Fed. 445 (1896).

stock in another, because it involves the investment of the corporate funds in an enterprise over which the corporate officers have no control, and risks them in a business which is foreign to that for which the stockholders advanced their money. But it has been decided that a power to acquire stock in another company may be implied from the power to consolidate with such company, as a proper step towards consolidation, or as necessarily included in the grant of so large a power."

It is clear that for the purpose of consolidating, — real and not assumed, — power to purchase stock may be implied from power to consolidate, but it cannot be true that the one is "necessarily included in the grant of" the other, so that a corporation, having power to consolidate, may purchase stock merely for the purpose of obtaining control. As said by the Supreme Court of New Jersey in *Elkins v. Camden, etc. R. Co.*:<sup>1</sup> "Union and consolidation of two railroad companies are one thing, and the purchase by one company of the property and franchises of the other, is another. What the defendant proposes to do is, not to unite and consolidate with the other company, but to purchase the means of controlling the property and franchises of that company. . . . The transaction under consideration must be regarded as an agreement to buy stock and bonds. . . . As such, irrespective of the assumed ulterior object in the purchase, it is not even suggested that it is legitimate."

Upon similar principles, a corporation having express power to purchase the property and franchises of another corporation has, as an incident thereto, power to purchase the stock of such corporation for the purpose of thereby acquiring the property and franchises, but not for the purpose of merely obtaining an interest in the corporation or of controlling it.<sup>2</sup>

<sup>1</sup> *Elkins v. Camden, etc. R. Co.*, 36 N. J. Eq. 12 (1882).

<sup>2</sup> It has, however, been held that, under a *Tennessee* statute authorizing a corporation to acquire, by purchase or other lawful contract, and to hold the property of another corporation of a similar kind, such a corporation might purchase the majority of the

stock of another corporation to enable it to control it, and exercise practical ownership over it. *Wehrhane v. Nashville, etc. R. Co.*, 4 N. Y. St. Rep. 541 (1886).

See also *Dewey v. Toledo, etc. R. Co.*, 91 Mich. 351 (1892), (51 N. W. Rep. 1063).

That power to lease another com-



§ 280. **Incidental Power to take Stock upon Reorganization.** — While it may be beyond the implied powers of a corporation to invest its funds in the stock of another corporation, yet when it becomes the owner of bonds of another company, which undergoes a process of reorganization involving the issue of stock in a new company in place of the bonds of the old, the former corporation has implied power to exchange its bonds for stock.<sup>1</sup> This power is merely a variation of the incidental power to take stock in payment or compromise of a debt.

§ 281. **Incidental Power to take Stock in Exchange for Corporate Assets.** — Upon principles already considered at length, a corporation has no implied power to transfer its entire property to another corporation in exchange for its shares. The acquisition of stock, in such a manner, is *ultra vires* and an infringement upon the rights of dissenting stockholders.<sup>2</sup>

pany's railroad may include power to buy its shares was held in *Atchison, etc. R. Co. v. Fletcher*, 35 Kan. 247 (1886), (10 Pac. Rep. 596).

<sup>1</sup> In *Deposit Bank v. Barrett*, 11 Ky. Law Rep. 910 (1890), (13 S. W. Rep. 337), the Court said: "A bank, it is true, has no power to invest its means in railroads, as coming within the scope of its powers as a corporation. It may accept mortgages, stock, or even purchase the road itself, to secure its debts, and we perceive no reason why the bank could not have accepted stock in the new company in payment of what was owing by the old company."

See also *Morgan v. King*, 27 Colo. 539 (1900), (63 Pac. Rep. 416).

<sup>2</sup> See *ante*, ch. XI., subdiv. II.: "*Exchange of Property of One Corporation for Stock of Another*," §§ 118-122.

In the preceding part of this treatise this subject is considered with especial reference to the rights of dissentient stockholders. The following cases are upon the point that

a transfer of corporate assets for stock is *ultra vires*.

In *Easun v. Buckeye Brewing Co.*, 51 Fed. 156 (1892), an Ohio corporation — a solvent concern — contracted to sell all its plant and assets and take in payment stock and bonds of another corporation to be reorganized to carry on the business. It was held that the contract was *ultra vires* — that one corporation could not become the owner of stock of another unless expressly authorized. The Court stated, however, that an insolvent corporation might make such transfer under certain circumstances. In *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304), an insolvent manufacturing company, without express authority, transferred all its property to another corporation, receiving in return shares of the latter company. This was done, not for the purpose of winding up the company's affairs and dividing the stock or its avails among the stockholders, but to keep the insolvent corporation alive and transact

§ 282. **Miscellaneous Instances of Incidental Power to acquire Stock.** — It has been held that a corporation, in order to borrow money for use in its business, may subscribe for stock in a building and loan association.<sup>1</sup> The authorities, however, are not uniform as to the existence of such an inci-

business through the agency of another corporation. *Held*, that the transfer was *ultra vires* and void.

See also *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896), (31 L. R. A. 415); *Mackintosh v. Flint*, etc. R. Co., 34 Fed. 583 (1888); *Taylor v. Earle*, 8 Hun (N. Y.), 1 (1876); *Boston, etc. R. Co. v. New York, etc. R. Co.*, 13 R. I. 260 (1881).

In *Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co.*, 127 N. Y. 252 (1891), (27 N. E. Rep. 831, 24 Am. St. Rep. 448), the New York Court of Appeals, although deciding the case upon other grounds, said that, all the stockholders agreeing, the question whether the acquisition of stock for corporate property was *ultra vires* depended rather upon whether it was necessary to take the stock in the exercise of the corporate franchises and transaction of the corporate business than upon the question whether there was an intention to immediately sell it and wind up the company's affairs. See also *Howe v. Boston Carpet Co.*, 16 Gray (Mass.), 493 (1860).

In *Taylor v. North Star Gold Mining Co.*, 79 Cal. 285 (1889), (21 Pac. Rep. 753), where a mining corporation transferred its mine for stock in another corporation, it was held that the transaction could not be collaterally attacked as *ultra vires*. See also *Wagner v. Marple*, 10 Tex. Civ. App. 505 (1895), (31 S. W. Rep. 691).

It has been held that the transfer of corporate assets for stock, without specific authority, is not *ultra vires* when the stock is "taken with a view to sell it again and not permanently

to hold it." *Hodges v. New England Screw Co.*, 1 R. I. 347 (1850), (53 Am. Dec. 624). See also *Byrne v. Schuyler Electric Mfg. Co.*, 65 Conn. 336 (1895), (31 Atl. Rep. 833, 28 L. R. A. 304); *Easun v. Buckeye Brewing Co.*, 51 Fed. 156 (1892); *Buford v. Keokuk, etc. R. Co.*, 3 Mo. App. 159 (1876); *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543 (1869), (90 Am. Dec. 300). But this does not mean, necessarily, that such a transfer, although *intra vires*, is effective against dissenting stockholders. The conclusion that a corporation has power does not imply that a majority may always exercise it. As pointed out in the sections referred to, minority stockholders have the right to insist that corporate assets shall be sold, not exchanged, when the exigencies of the corporation require their disposition.

<sup>1</sup> *Union, etc. Ass'n v. Masonic Hall Ass'n*, 29 N. J. Eq. 389 (1878); *State v. Rohlfes* (N. J. 1890), 19 Atl. Rep. 1099; *Norwalk Savings Bank Co. v. Norwalk Metal Spinning, etc. Co.*, 14 Ohio Cir. Ct. Rep. 1 (1897). *Compare Wilson's Case*, L. R. 12 Eq. 516 (1871); *Kadish v. Garden City, etc. Ass'n*, 151 Ill. 531 (1894), (38 N. E. Rep. 536, 42 Am. St. Rep. 256).

It has been held that a corporation which becomes a stockholder of, and a borrower from, a building and loan association, although acting beyond its powers, is estopped from pleading *ultra vires* to a suit to enforce the security given. *Bowman v. Foster, etc. Co.*, 94 Fed. 592 (1899); *Blue Rapids Opera House Co. v. Mercantile Building, etc. Ass'n* (Kan. 1898), 53 Pac. Rep. 761.

dental power.<sup>1</sup> The primary object of a building association is to enable its members to own their homes, and a subscription by a corporation to such an association would seem, upon principle, to be *ultra vires* both of the corporation and the association.

A manufacturing corporation, as a means of insuring its property, may become a member of a mutual fire insurance company.<sup>2</sup> A land and development company, having power to build a short railroad in connection with the development of its wild lands, may, it has been held, subscribe for stock in a railroad furnishing access to such lands.<sup>3</sup>

A subscription by a hotel company to a corporation projected for the purpose of holding an international military encampment, which might bring large numbers of strangers to the city in which the hotel of the subscribing company was located and increase its business, was said, by the Supreme Court of Illinois, not to be so foreign to the business of keeping a hotel as to call for the application of the doctrine of *ultra vires*.<sup>4</sup>

<sup>1</sup> In *Mechanics, etc. Bank v. Meriden Agency Co.*, 24 Conn. 159 (1855), a joint stock corporation organized "to do a general insurance agency, commission and brokerage business" was held to have no power to subscribe for the stock of a building and loan association, and the loan was treated as if made to a stranger.

In *German American, etc. Ass'n v. Droge*, 14 Ind. App. 691 (1895), (43 N. E. Rep. 475), it was held that one building and loan association had no power to accept stock of another such association in payment for its own stock.

<sup>2</sup> *St. Paul Trust Co. v. Wampach Mfg. Co.*, 50 Minn. 93 (1892), (52 N. W. Rep. 274).

<sup>3</sup> *Watt's Appeal*, 78 Pa. St. 370 (1875).

Compare cases referred to in the text with the decision of the Supreme Court of Illinois in *People v. Pullman Car Co.*, 175 Ill. 125 (1898), (51 N. E. Rep. 664, 64 L. R. A. 366), where

it was held that, in the absence of express statutory authority, one corporation could not hold stock in another, although the latter, while existing as an independent company, was in fact a mere department or agency of the former.

<sup>4</sup> *Richelieu Hotel Co. v. International, etc. Co.*, 140 Ill. 248 (1892), (29 N. E. Rep. 1044, 33 Am. St. Rep. 234). This decision can be justified, if at all, only upon the ground that the subscription was really a *donation* which the corporation might have made in the expectation of reaping a benefit in return. It should be compared with that of the Supreme Court of Georgia in *Military Interstate Ass'n v. Savannah, etc. R. Co.*, 105 Ga. 421 (1898), (31 S. E. Rep. 200): "We agree with the trial judge in holding that, under the facts alleged, the attempted subscription of the defendant to the capital stock of the plaintiff association was an act *ultra vires* and, there-

§ 283. **Presumption of Power to hold Stock.** — *Omnia acta rite esse praesumuntur.* The law presumes that a corporation acts within the scope of its powers. Corporations are authorized to acquire the stock of other corporations for certain purposes, and under certain conditions. When, therefore, a corporation takes stock, it will be presumed that it acquires it for an authorized purpose. The burden of proof is upon the person alleging that the corporation has exceeded its powers.<sup>1</sup>

§ 283a. **An Analogous Power.** — Only the power of one corporation to hold stock in another corporation involves intercorporate relations. A full consideration of corporate stockholding, however, requires an examination of the power of a corporation to acquire and hold its own stock. That subject, therefore, is treated in the subjoined note.<sup>2</sup>

fore, void, although it is conceivable that, because of the 'competitive drills, rifle contests, shot-gun tournaments, . . . the business of the railway company might be incidentally increased, if it affirmatively appeared that its line ran to the grounds upon which these fascinating and diverting performances were to take place."

<sup>1</sup> *Evans v. Bailey*, 66 Cal. 112 (1884), (4 Pac. Rep. 1089). And see *Ryan v. Leavenworth, etc. R. Co.*, 21 Kan. 365 (1879).

In *Burden v. Burden*, 159 N. Y. 305 (1899), (54 N. E. Rep. 17), the New York Court of Appeals said: "As to the stocks of outside companies held by the corporation there are various statutory provisions that permit this holding under certain limitations. The appellant urges that there is no evidence and no finding that the Burden Iron Company held those stocks lawfully. The burden of proof was upon the plaintiff to show that the stocks were illegally held, and, in the absence of such proof, the court will assume that the action of the corporation is legal."

Where, in proceedings to condemn land for railroad purposes, it appeared that one of the subscribers to the capital stock of the petitioner was a

corporation, and that its subscription was essential to make up the required amount to be paid before condemning, it was held that, in the absence of any proof, it would not be presumed against the act of the corporation and its payment of the percentage, that it acted beyond its powers. As to whether the land owners could raise or try the question, *quære*. *Matter of Rochester, etc. R. Co.*, 110 N. Y. 119 (1888), (17 N. E. Rep. 678).

*Compare*, however, *Parsons v. Tacoma Smelting, etc. Co.* 25 Wash. 508 (1901), (65 Pac. Rep. 770), where the Court said: "As has been observed, the new company holds a majority of the stock of the old company. Some confusion arises upon the investigation into the right of one corporation to hold stock in another, or become a member thereof, when the inquiry is made into prohibitions upon the powers of a corporation, rather than directed to the enumeration of powers conferred upon it. It has always been true that corporations have only such powers as are granted to them by the State, and, when a corporate act is questioned, the affirmative is upon the corporation to show its authority."

<sup>2</sup> POWER OF CORPORATION TO

ACQUIRE AND HOLD ITS OWN STOCK.

I. *English doctrine.*

As already shown, the English courts generally hold that a private corporation has power to acquire and hold the stocks of other corporations without express statutory authority, while the weight of American authority supports the contrary view. (*Ante*, §§ 264, 265.) On the other hand, rather curiously, the English courts deny that a corporation, without express authority, has power to take and hold its own stock, while the prevailing American view is that such implied power exists.

The leading English case holding that corporations, regardless of their nature, cannot purchase, hold or deal in their own shares is *Trevor v. Whitworth*, 12 App. Cas. 409 (1887). The power was denied in this case upon these grounds:

(a) If the company is to sell the shares again the purchase is a trafficking in shares and *ultra vires*.

(b) If the company is to retain the shares such a purchase is an indirect method of reducing the capital of a company in contravention of Acts specifically prescribing how capital may be reduced.

(c) The protection of creditors requires that the capital of a corporation should not be, directly or indirectly, returned to its shareholders.

Another ground for denying such an implied power is urged in *Brice's Ultra Vires* (2d ed.), 134: "There are also considerations of public policy — dealings by a company in its own shares tend indirectly to breaches of duty on the part of the directors and to fraud and rigging the market on the part both of the corporation itself and of its officials."

Other English cases stating the doctrine there adhered to are *Bellerby v. Rowland*, etc. S. S. Co., 2 Ch. 14 (1902); *Hope v. International Financial Soc.*, L. R. 4 Ch. Div. 327 (1876);

*Re London*, etc. Bank, L. R. 5 Ch. App. 444 (1870). Compare *Re Dronfield Silkstone Coal Co.* L. R. 17 Ch. Div. 76 (1880).

II. *American decisions adopting English doctrine.*

The view that a corporation, except to save itself from loss, has no implied power to acquire and hold its own shares is supported by the following American decisions:

*United States*: *Hamor v. Taylor-Rice Engineering Co.*, 84 Fed. 392 (1897).

*California*: *Bank of San Luis Obispo v. Wickersham*, 99 Cal. 655 (1893), (34 Pac. Rep. 444).

*Connecticut*: *Crandall v. Lincoln*, 52 Conn. 73 (1884), (52 Am. Rep. 560). In this case, however, such an implied power was recognized to a limited extent.

*Kansas*: *Abeles v. Cochrane*, 22 Kan. 405 (1879), (31 Am. Rep. 194).

*Louisiana*: *Bartlett v. Fourton*, 115 La. Ann. 26 (1905), (38 So. Rep. 882).

*Maryland*: *Maryland Trust Co. v. National Mechanics Bank*, 102 Md. 608 (1906), (63 Atl. Rep. 70).

*Missouri*: *St. Louis Carriage Mfg. Co. v. Hilbert*, 24 Mo. App. 338 (1887).

*New Hampshire*: *Currier v. Lebanon Slate Co.*, 56 N. H. 262 (1875).

*Ohio*: *Coppin v. Greenlees*, etc. Co., 38 Ohio St. 275 (1882), (43 Am. Rep. 425); *State v. Oberlin Building Ass'n*, 35 Ohio St. 258 (1879).

*Tennessee*: *Cartwright v. Dickin-son*, 88 Tenn. 476 (1890), (12 S. W. Rep. 1030, 17 Am. St. Rep. 910, 7 L. R. A. 706); *Herring v. Ruskin Coö. Ass'n*, 52 S. W. Rep. 327 (1899).

The most recent statement of the grounds for denying the implied power of corporations to acquire their own shares is contained in *Maryland Trust Co. v. National Mechanics Bank*, 102 Md. 608 (1906), (63 Atl. Rep. 70): "In several States the power of a corporation to purchase

its own shares has been denied and it has been held that, in the absence of express authority, a corporation, the amount of whose capital stock is fixed in its charter, has no power to purchase its own shares, either for the purpose of holding or selling them, or for the purpose of cancelling and retiring them. The reasons given for the doctrine, apart from any express or implied statutory prohibition, are that the purchase of its own stock by a corporation is not only a fraud upon the creditors who deal with the corporation on the faith that the capital is paid up, and a fraud upon and violation of the contract with stockholders who do not consent, but is also a violation of the charter."

The last objection noted by the Maryland court — *ultra vires* — is the strongest. If there were no creditors and all the stockholders agreed, the objection of fraud would not be well taken. And if the shares were purchased and reissued, the objection noted in the English case and stated in several American decisions that such purchase amounts to a reduction of the capital, would be unfounded.

When the purchase of its shares is beyond the powers of a corporation the result cannot be accomplished by taking them in the name of a trustee or agent. *Crandall v. Lincoln*, 52 Conn. 73 (1884), (52 Am. Rep. 560); *Trevor v. Whitworth*, 12 App. Cas. 409 (1887).

III. *Exceptions to strict rule. Power of corporation to take its own stock in payment of debt.*

Even the courts which most strongly deny any broad implied power in a corporation to acquire its own shares, hold that it has such power when necessary to save itself from loss, and may take its shares as security for, or in payment of existing indebtedness. As said in *Maryland Trust Co. v. National Mechanics Bank*, *supra*: "It is true, however, that in most jurisdictions where the right of

the corporation to traffic in its own shares is denied, an exception to the rule has been admitted to exist, whereby a corporation has been allowed to take its own stock in satisfaction of a debt due it. This right is supposed to rest on a necessity which arises in order to avoid loss."

See also: *Crandall v. Lincoln*, 52 Conn. 73 (1884), (52 Am. Rep. 560); *Coppin v. Greenlees, etc. R. Co.*, 38 Ohio St. 275 (1882), (43 Am. Rep. 425); *State v. Oberlin Building, etc. Ass'n*, 35 Ohio St. 258 (1879); *Barto v. Nix*, 15 Wash. 563 (1896) (46 Pac. Rep. 1033); *Savings Bank v. Wulfe-kuhler*, 19 Kan. 65 (1877); *Barton v. Port Jackson, etc. Road Co.*, 17 Barb. 397 (1854).

For consideration of provisions of National Banking Act prohibiting national banks from taking their own shares except when necessary to prevent loss upon an existing indebtedness see *post*, § VI. of this note.

IV. *Prevailing American doctrine.*

Upon principle, it is difficult to see how the power to take and hold its own stock — a power necessarily producing extraordinary complications — can be among the implied powers of a corporation. Still, the prevailing doctrine of the American courts is that such power exists. In fact with respect to the weight of authority the Supreme Court of Montana is not without justification in saying (*Porter v. Plymouth Gold Mining Co.*, 29 Mont. 357 (1903), (74 Pac. Rep. 938)): "We believe the rule to be well settled in the United States by the overwhelming weight of authority and reason that a private corporation may purchase its own stock if the transaction is fair and in good faith; if free from fraud, actual or constructive; if the corporation is not insolvent, or in process of dissolution; and if the rights of the creditors are in no way affected thereby."

It may be stated, therefore, as the

American rule, that, in the absence of statutory prohibition, a corporation has power to purchase and hold its own stock provided (1) that it acts in good faith and (2) that the rights of creditors and stockholders are not prejudiced. And, stated reciprocally, it cannot make such purchase to carry out a fraudulent purpose or when it will operate to the injury of creditors or any part of the stockholders.

*United States*: *Burnes v. Burnes*, 137 Fed. 789 (1905); *In re Castle Braid Co.*, 145 Fed. 232 (1906); *In re Smith Lumber Co.*, 132 Fed. 619 (1904); *Lowe v. Pioneer Threshing Co.*, 70 Fed. 646 (1895); *First National Bank v. Salem Capital Flour Mills Co.*, 39 Fed. 89 (1889). See also *Johnson County v. Thayer*, 94 U. S. 631 (1876).

*Illinois*: *Commercial Nat. Bank v. Burch*, 141 Ill. 519 (1892), (33 Am. St. Rep. 331); *Chicago St. R. Co. v. Marseilles*, 84 Ill. 145 (1876); *Clapp v. Peterson*, 104 Ill. 26 (1882).

*Iowa*: *State v. Higby Co.*, 130 Iowa, 69 (1906), (106 N. W. Rep. 382); *Rollins v. Shaver Co.*, 80 Iowa, 380 (1890), (45 N. W. Rep. 1037, 20 Am. St. Rep. 427); *Iowa Lumber Co. v. Foster*, 49 Iowa, 25 (1878), (31 Am. Rep. 140).

*Massachusetts*: *New England Trust Co. v. Abbott*, 162 Mass. 148 (1894), (38 N. E. Rep. 432), (27 L. R. A. 271); *Dupee v. Boston Water Power Co.*, 114 Mass. 37 (1873).

*Nebraska*: *Fremont Carriage Mfg. Co. v. Thomsen*, 65 Neb. 370 (1902), (91 N. W. Rep. 376).

*New York*: *City Bank v. Bruce*, 17 N. Y. 507 (1858). In this case, however, the stock was taken to secure a debt. See also *Joseph v. Raff*, 82 App. Div. 47 (1903), (81 N. Y. Supp. 546), *affirmed* 176 N. Y. 611 (1903), (68 N. E. Rep. 1118).

*North Carolina*: *Blalock v. Kernersville Mfg. Co.*, 110 N. C. 99 (1892), (14 S. E. Rep. 501).

*Pennsylvania*: *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. St. 370 (1895), (31 Atl. Rep. 656).

*Texas*: *Howe Grain, etc. Co. v. Jones*, 21 Tex. Civ. App. 198 (1899), (51 S. W. Rep. 24).

*Vermont*: *State v. Smith*, 48 Vt. 266 (1876); *Farmers, etc. Bank v. Champlain Trans. Co.*, 18 Vt. 131 (1846).

*Wisconsin*: *Marvin v. Anderson*, 111 Wis. 387 (1901), (87 N. W. Rep. 226).

V. *Statutory authority for corporation to acquire its own stock.*

In several States general corporation acts expressly authorize corporations organized thereunder to take and hold, under varying conditions, their own stock.

In other States the power is held to be included by implication in the grant of corporate powers. Thus with respect to the Corporation Act of New Jersey the New Jersey Supreme Court in *Chapman v. Ironclad Rheostat Co.*, 62 N. J. Law, 498 (1898), (41 Atl. Rep. 690) said: "The provisions of our Corporation Act by which (§ 20) the shares of stock in every corporation are declared to be personal property and (§ 1) every corporation is vested with power to purchase such personal estate as the purposes of the corporation shall require, except (§ 3) certain designated sorts of personal property which do not embrace shares of its own capital stock, coupled with those provisions which recognize the power of corporations to own shares of their own capital stock (§§ 29, 38) plainly imply a legislative grant of the necessary power in all cases where the purposes of the corporation require it." See also *Berger v. U. S. Steel Corp'n*, 63 N. J. Eq. 809 (1902), (53 Atl. Rep. 68); *Oliver v. Rahway Ice Co.*, 54 Atl. Rep. 460 (N. J. Ch. 1903).

Statutory power to purchase "property" has been held to author-

ize a corporation to purchase its own stock. *Iowa Lumber Co. v. Foster*, 49 Iowa, 25 (1878), (31 Am. Rep. 140). And a similar conclusion was reached with respect to a charter provision authorizing a corporation to purchase and sell every kind of "goods, chattels and effects." *Robison v. Beall*, 26 Ga. 17 (1858). Compare, however, *Barton v. Port Jackson*, etc. R. Co., 17 Barb. 397 (1854); *Re London Bank*, L. R. 5 Ch. App. 444 (1870); *Re Dronfield Silkstone Coal Co.*, L. R. 17 Ch. Div. 76 (1880).

For provision in articles of association giving corporation power to acquire its own shares see *Re Sovereign Life Ass. Co.*, 3 Ch. 279 (1892).

A provision in the charter of a corporation giving it a preference in the purchase of its stock, if valid, is for the benefit of the corporation alone and not for the benefit of the individual stockholders.

*Bartlett v. Fourton*, 115 La. 26 (1905), (38 So. Rep. 882).

VI. *Statutory prohibitions against corporation acquiring its own stock.*

Statutes sometimes expressly forbid corporations purchasing or holding their own shares. Thus a Colorado statute (Mills' Anno. Stat. § 485) prohibits the use by corporations of any of their funds "for the purchase of stock in their own company or corporation, except such as may be forfeited for the non-payment of assessments thereon." For construction of this statute see *Ophir Consol. Mines Co. v. Bryntesen*, 143 Fed. 829 (1906); *Kassler v. Kyle*, 28 Colo. 374 (1901), (65 Pac. Rep. 34).

The National Banking Act (U. S. Rev. Stat. § 5201) declares that "no association shall make any loan or discount on the security of its own capital stock, nor be the purchaser or holder of any such shares, unless such security or purchase shall be necessary to prevent loss upon a debt previously contracted in good faith; and the stock so purchased

or acquired shall, within six months from the time of its purchase, be sold or disposed of." For construction of this statute see *National Bank of Xenia v. Stewart*, 107 U. S. 676 (1882); *Bank v. Lanier*, 11 Wall. (U. S.) 369 (1870).

The provisions of the stock corporation law of New York that a corporation shall only pay dividends from surplus profit and shall not "divide, withdraw or in any way pay the stockholders, or any of them, any part of its capital stock" does not operate as a prohibition against the purchase by a corporation of its own stock. *In re Castle Braid Co.*, 145 Fed. 224 (1906).

VII. *Status of corporation as holder of its own stock.*

In the absence of appropriate action, the mere acquisition by a corporation of its own shares does not reduce its capital stock. The presumption is that the corporation intends to enjoy them as property and reissue them.

*Vail v. Hamilton*, 85 N. Y. 453 (1881); *Commonwealth v. Boston*, etc. R. Co., 142 Mass. 146 (1886); *American Railway-Frog Co. v. Haven*, 101 Mass. 398 (1869), (3 Am. Rep. 377); *State v. Smith*, 48 Vt. 266 (1876).

A corporation, however, having power to reduce its capital stock may undoubtedly make such reduction by duly cancelling shares which it has purchased.

A corporation holding its own stock has no right to vote it, and it is immaterial whether the stock stands in the name of the corporation or of a trustee in its behalf.

*American Railway-Frog Co. v. Haven*, 101 Mass. 398 (1869), (3 Am. Rep. 377); *Brewster v. Hartley*, 37 Cal. 15 (1869), (99 Am. Dec. 237); *Monsseaux v. Urquhart*, 19 La. Ann. 482 (1867). In *Farwell v. Houghton Copper Works*, 8 Fed. 66 (1881), however, it was said that such stock



might be voted when all of the stock of the corporation was represented at the meeting and all consented that the treasurer vote it.

VIII. *Rights and remedies of creditors.*

As already shown, even the courts which hold that corporations have implied power to take and hold their own shares attach the limitation that the rights of creditors must not be prejudiced. And this limitation — upon the ground that the capital stock of a corporation is a trust fund for its creditors — has been applied in favor of a creditor who became such subsequent to the agreement by the corporation to purchase its shares but before it was sought to be carried into effect. *Olmstead v. Vance etc. Co.*, 196 Ill. 236 (1902), (63 N. E. 634). See also *Clapp v. Peterson*, 104 Ill. 26 (1882). But it is held that persons who did not

become creditors until after the actual employment of the funds of the corporation to purchase its shares cannot complain. *Marvin v. Anderson*, 111 Wis. 387 (1901), (87 N. W. Rep. 226); *Shoemaker v. Washburn Lumber Co.*, 97 Wis. 585 (1897), (73 N. W. Rep. 333).

Where the funds of a corporation have been wrongfully applied in the purchase of its shares, it is held that a receiver of the corporation, in behalf of creditors, may recover them back. *Tait v. Pigott*, 32 Wash. 344 (1903), (73 Pac. Rep. 364); *Crandall v. Lincoln*, 52 Conn. 73 (1884), (52 Am. Rep. 560); *Commercial Nat. Bank v. Burch*, 141 Ill. 519 (1892), (31 N. E. Rep. 420, 33 Am. St. Rep. 331). And it has also been held that a judgment creditor may follow in equity property transferred in payment for such stock. *Clapp v. Peterson*, 104 Ill. 26 (1882).

## CHAPTER XXVI

## RIGHTS AND OBLIGATIONS OF CORPORATION AS STOCKHOLDER

I. *Intra Vires Holdings*

- § 284. *Status of Corporation holding Stock.*
- § 285. *Nature of "Holding Corporations."*
- § 286. *Rights of Foreign Corporation holding Stock.*
- § 287. *Incidents of Ownership attach to Intra Vires Holdings.*
- § 287a. *Collateral Trust Bonds.*

II. *Ultra Vires Holdings*

- § 288. *What Incidents of Ownership attach to Ultra Vires Holdings.*
- § 288a. *Status of Parties to Ultra Vires Purchases of Stock.*
- § 289. *Liability for Assessments upon Ultra Vires Holdings.*
- § 290. *Ultra Vires Contracts for Purchase of Stock. Who may question Validity of Ultra Vires Purchases. Dependent Contracts.*
- § 291. *Independent Contracts.*
- § 292. *Holding Stock to prevent Competition.*
- § 293. *Remedies in Case of Ultra Vires Stockholding.*

I. *Intra Vires Holdings*

§ 284. **Status of Corporation holding Stock.** — The lawful acquisition by one corporation of stock in another — even to the extent of holding all its shares — in no way affects the legal entity of the two corporations, as between themselves, and each continues its separate existence.<sup>1</sup> This is an application of the rule — necessary in the relations between a corporation and its stockholders, and between a corporation and third persons, — that a corporation is an entity distinct

<sup>1</sup> In *Exchange Bank v. Macon, etc.* Co., 97 Ga. 5 (1895), (25 S. E. Rep. 326), Judge Lumpkin said: "Every corporation is a person — artificial, it is true, but nevertheless a distinct legal entity. Neither a portion nor all the natural persons who compose a corporation, or who own its stock and control its affairs, are the corporation itself; and when a single individual composes a corporation, he is not himself the corporation. In such a case, the man is one person,

created by the Almighty, and the corporation is another person, created by the law. It makes no difference in principle whether the sole owner of the stock of a corporation is a man or another corporation. The corporation owning such stock is as distinct from the corporation whose stock is so owned, as the man is from the corporation of which he is a member." See also *Button v. Hoffman*, 61 Wis. 20 (1884), (20 N. W. Rep. 667, 50 Am. Rep. 131).

and apart from its stockholders. It is, however, founded upon a legal fiction, and may be disregarded in the relations between a corporation and the State.

A corporation, as a stockholder, has all the rights of other stockholders, and is equally subject to the corresponding obligations.<sup>1</sup>

§ 285. **Nature of "Holding Corporations."** — In a broad sense, any corporation, having power to hold stock in another corporation, becomes, upon its exercise, a "holding corporation." The phrase in modern corporation law, however, is applied specifically to corporations organized, under statutes conferring the power, for the express purpose of acquiring and holding the stock of other corporations.

The essential feature of a holding corporation is that it *holds* stock. A corporation which deals in stocks is not a holding corporation.

The holding corporation is the modern device for uniting corporate interests. Consolidation requires the formal vote of a stipulated majority of the stockholders, and the termination of the existence of one or more of the corporations. In case of a sale, the vendor's interests in the corporate property are parted with absolutely. In case of a lease, the lessor has no other interest than the rental and remainder. Express legislative authority is, moreover, essential in case of consolidation, sale, or lease. The holding corporation, on the other hand, is a flexible agency. Its power depends upon *its* charter. The only prerequisite to the practical union of two or more corporations through a holding corporation, is the ownership of a bare majority of the capital stock of each company. The only formality is the transfer of the shares to the holding corporation.

The fiction of distinct corporate existence may lead to the conclusion that, although the control of several corporations is held by a single company, the corporations themselves remain separate and distinct as before. But while this conclusion,

<sup>1</sup> A county which aids in the building of a railroad and receives shares in the company owning it does not hold them in a governmental capacity but in the same way and with

the same rights and duties as a private corporation or individual.

Hind County v. Natchez, etc. R. Co., 85 Miss. 599 (1905), (38 So. Rep. 189).

in a merely technical sense, may be well founded, it hardly warrants the corollary — convenient in some cases — that two corporations controlled by a single stockholder in its own interest, are *in reality* competing companies and entirely independent.

Holding corporations have taken the pace of the earlier "trusts" in the formation of industrial combinations. They have also been employed to effect a practical consolidation of railroad companies. Their validity, in such instances, depends upon considerations of public policy, comity between States and the applicability of federal and State anti-trust statutes.<sup>1</sup>

The advantages of a holding corporation may be enumerated as follows:

1. It furnishes a readily available and effective method of controlling several corporations for a common object. Its uses for this purpose have already been indicated.

2. It may be employed to perpetuate corporate control. Financiers holding the control of corporations may transfer their shares to a holding corporation. Death or disagreement will not then affect the control. In many cases also a holding corporation may take the place of a voting trust — an expedient always of doubtful validity.

3. The holding corporation permits the capitalization of controlling stock interests. The control of a corporation having a capital of twenty million dollars — as an illustration —

<sup>1</sup> Where a holding corporation — the Northern Securities Company — in pursuance of a plan of combination acquired controlling stock interests in two corporations — the Northern Pacific Railroad Company and the Great Northern Railroad Company — through the exchange with the stockholders of such corporations of its own shares for the shares of such corporations, it was held that the contract of exchange was, in legal effect, one of purchase and sale, and that the holding corporation became the absolute owner of the shares which it acquired free from any trust in favor of any of the stockholders of the controlled corporations, and that

upon the winding up of its affairs — after having been declared an illegal combination — it was entitled to distribute its holdings *pro rata* among its stockholders.

Harriman v. Northern Securities Co., 197 U. S. 244 (1904), (25 Sup. Ct. Rep. 493). See also *post*, § 397a: "*The Northern Securities Case.*"

Where a holding corporation procured a loan in order to obtain working capital for the companies controlled it was held that it was entitled to charge such companies their proportionate shares of the expenses incurred in negotiating the loan.

Dittman v. Distilling Co., 64 N.J. Eq. 537 (1903), (54 Atl. Rep. 570).

requires a permanent investment of more than ten million dollars, assuming the stock worth par. If a holding corporation is formed, with a capital equal to the investment, the shares may be transferred to it and forty-nine per cent of its stock sold. The original controlling stockholders, by retaining control of the holding corporation, retain control of the original corporation. Through the formation of a series of holding corporations, it is conceivable that the majority stockholders of a holding corporation of a thousand dollars capital, might hold the ultimate control of a corporation of a million dollars capital.

§ 286. **Rights of Foreign Corporation holding Stock.** — The right of a corporation of one State to subscribe for or acquire shares of stock in a corporation of another State depends, primarily, upon the extent of its chartered powers and the laws of the State of its incorporation. If it is without the power in the State of its creation, it is without the power everywhere.

A corporation, having power to subscribe for stock in other corporations, may exercise the power in another State if the laws and policy of that State permit.<sup>1</sup> In the absence of language clearly including corporations in a grant of power to become incorporators, a foreign corporation could not participate in the formation of a corporation, but its disability would arise from its corporate, and not from its foreign, character. Corporations are not "persons" who are authorized to form corporations;<sup>2</sup> but, in absence of statutory provision, there is no distinction between residents and non-residents in the right to become incorporators or subscribers.<sup>3</sup>

<sup>1</sup> *Rogers v. Nashville, etc. R. Co.*, 91 Fed. 312 (1898): "It is impossible in the present state of Tennessee legislation to say that this charter power is either opposed to any law or policy of that State. Upon the contrary . . . the special charter . . . expressly invites such ownership by providing that 'any State or any citizen, corporation or company of this or any other State or country may subscribe for and hold stock in

said company.'" *Compare Merz Capsule Co. v. United States Capsule Co.*, 67 Fed. 414 (1895).

<sup>2</sup> *Factors, etc. Ins Co. v. New Harbor Protection Co.*, 37 La. Ann. 233 (1885); *Denny Hotel Co. v. Schram*, 6 Wash. 134 (1893), (32 Pac. Rep. 1002, 36 Am. St. Rep. 130).

<sup>3</sup> *Moxie Nerve Food Co. v. Baumbach*, 32 Fed. 205 (1887); *Commonwealth v. Hemmingway*, 131 Pa. St. 614 (1890), (18 Atl. Rep. 990); *Cen-*

A corporation, having power to purchase stock, may purchase the shares of foreign corporations, unless the laws or policy of the State of their creation forbid such acquisition.<sup>1</sup> In *Rogers v. Nashville, etc. R. Co.*<sup>2</sup> Judge Lurton, in speaking of the right of a foreign railroad company to purchase stock in a domestic corporation, said: "Such a purchase was not in excess of its chartered power, for the express power was conferred by an amendment of its charter. . . . Comity requires that this charter power shall be recognized as valid if not opposed to some law or policy of the State creating the corporation in which stock has been acquired."<sup>3</sup>

tral R. Co. v. Pennsylvania R. Co., 31 N. J. Eq. 475 (1879); *Humphreys v. Mooney*, 5 Colo. 282 (1880).

<sup>1</sup> In *United Lines Tel. Co. v. Boston Safe Deposit, etc. Co.*, 147 U. S. 447 (1892), (13 Sup. Ct. Rep. 396), the Supreme Court of the United States said: "The general power of a corporation to hold property in States other than the one which incorporated it (in the absence of statutory prohibition in such States), is firmly established. The Bankers Company received the benefit of the August agreement through which alone it acquired control of the Rapid Company; it enjoyed that control, took all the receipts of the Rapid Company's business, profited by the good-will which that company had acquired, and thus obtained a benefit from the August agreement which is beyond its power to restore." See also *Rogers v. Nashville, etc. R. Co.*, 91 Fed. 299 (1898).

Comity between the States will not authorize a foreign corporation to exercise, in relation to stock in a domestic corporation, powers within the State which a domestic corporation would not be permitted to exercise under the constitution and policy of the State. *Clarke v. Central R., etc. Co.*, 50 Fed. 338 (1892), (15 L. R. A. 683). But compare later decision in same case, 62 Fed. 328 (1894). See

also *Coler v. Tacoma R., etc. Co.*, 65 N. J. Eq. 347 (1902), (54 Atl. Rep. 413, 103 Am. St. Rep. 786).

Under an early Pennsylvania statute prohibiting any foreign corporation from holding any real estate within the State, "directly in the corporate name or by or through any trustee or other device whatever," unless specially authorized by law, it was held that a corporation of another State could not, by purchasing the charter of a mining company, vesting the title to certain land in its name, and then taking the stock of the mining company, become the owner of the land; and that, in case of acquisition by such means, the land was liable to escheat in *quo warranto* proceedings under another statute. *Commonwealth v. New York, etc. R. Co.*, 114 Pa. St. 340 (1886), (7 Atl. Rep. 756).

<sup>2</sup> *Rogers v. Nashville, etc. R. Co.*, 91 Fed. 312 (1898).

<sup>3</sup> The Supreme Court of New Jersey has recently rendered a valuable decision with respect to the rights of New Jersey corporations to hold shares in corporations of other States, the laws or policy of which are opposed to corporate stockholding. In this case (*Coler v. Tacoma R. etc. Co.*, 65 N. J. Eq. 347 (1902), (54 Atl. Rep. 413, 103 Am. St. Rep. 786)) the Court said of the power of a New

When stock has been lawfully acquired by a foreign corporation, it has all the rights and powers, and is subject to all the liabilities, of other stockholders. The legislature can pass no law impairing the obligation of the contract between it, its fellow stockholders and the corporation, nor can its property be taken without "due process of law." Legislation cannot affect vested rights.

The rights of a foreign corporation within a State are, however, only those which comity between States per-

Jersey corporation to hold stock in a corporation of the State of Washington: "The courts of Washington have decided that one corporation cannot subscribe for, purchase, hold or vote upon the shares of stock of another corporation without legislative sanction, and that the Legislature of the State has never sanctioned such acts. . . . This doctrine rests altogether on considerations of public policy. But it is said that the policy as declared extends only to domestic corporations, and whether it should embrace foreign corporations is a matter to be decided by the courts of that State alone. I do not understand that the policy is so restricted. One of its objects is to prevent one corporation from interfering with the control of another. This was the purpose to be subserved by the decision just cited (*Parsons v. Tacoma Smelting, etc. Co.*, 25 Wash. 508 (1901), (65 Pac. Rep. 765)), where, although the title of the stockholding company was not assailed, its right to vote upon the stock was denied. It is true that the stockholding company was a domestic corporation, but the denial of its right to vote could not be based on that circumstance. The doctrine that it was impolitic to allow a corporation whose chartered powers were subject to modification at the will of the State to exercise control over a domestic corporation, would seem necessarily to imply that it was

deemed equally impolitic to permit such control by a corporation whose chartered powers were generally independent of the State. The application of the restriction to a foreign corporation is a mere interpretation, not an extension of the doctrine. But if it be an extension, the extension is made by the Constitution of Washington, which provides (article 12, § 7) that 'no corporation organized outside the limits of this State shall be allowed to transact business within the State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State.' The decisions already cited are clearly to this effect: that, if a Washington corporation owned property immovably fixed in that State, it could not lawfully bargain to exchange that property for stock in another Washington corporation, and after completion of the exchange exercise in the other corporation all the rights and privileges of a private stockholder. If this New Jersey corporation can lawfully do what is thus prohibited to a Washington corporation, then the foreign corporation is allowed to transact business in Washington on conditions more favorable than those prescribed for its domestic corporations. The Constitution forbids this. On these grounds we think that the carrying out of the arrangement should be enjoined."

mits.<sup>1</sup> The right to issue stock is in itself a franchise. "The power to create corporate capital stock is a legislative function."<sup>2</sup> The legislature in granting the power may attach such conditions to its exercise, and to the transfer of shares, as it may deem expedient.<sup>3</sup> It may enact statutes, having a prospective application, forbidding foreign corporations becoming, directly or indirectly, stockholders in domestic companies. It seems, moreover, upon principle, that while the legislature cannot destroy vested rights it may, under an unconditional reservation of power to repeal charters, repeal the charter of a domestic corporation on the ground that its stock is held by a foreign corporation and that it is controlled in a manner or for objects contrary to the policy of the State.<sup>4</sup> In such a case, the right of the corporation, as stockholder, to its share of the assets would be preserved.<sup>5</sup>

The holding by foreign corporations of the stock of domestic companies, for the purpose of destroying competition, is inimical

<sup>1</sup> In view of the fact that New Jersey issues most of the charters to corporations for the transaction of business in other States, an early decision as to the *status* of corporations of other States in New Jersey is interesting. In *Hill v. Beach*, 12 N. J. Eq. 31 (1858), it was said of a New York corporation: "[It] cannot be recognized by any court in New Jersey as a legally constituted corporation nor be dealt with as such. If it can be, what need is there of any general or special law in our State? Individuals desirous of carrying on any manufacturing business, may go into the city of New York, organize under the general laws of that State, erect all their manufacturing establishments here, and, under their assumed name, transact their business, not only free from all personal responsibility, but under cover of a corporation not amenable to our laws."

<sup>2</sup> *Cooke v. Marshall*, 191 Pa. St. 320 (1899), (43 Atl. Rep. 314), on rehearing, 196 Pa. St. 200 (1900),

(46 Atl. Rep. 447). See also *Railway Co. v. Allerton*, 18 Wall. (U. S.) 233 (1873).

<sup>3</sup> In *Commonwealth v. Standard Oil Co.*, 101 Pa. St. 119 (1882), an Ohio corporation owned shares of stock in Pennsylvania corporations, but never received any special authority to transact business in Pennsylvania. It was held that the ownership of shares in Pennsylvania corporations did not constitute "doing of business" in the commonwealth, so as to subject the corporation to taxation under an act requiring foreign corporations "doing business in this commonwealth" to pay a tax upon their capital stock.

<sup>4</sup> For consideration of general principle see *Spring Valley Water Works v. Schlottler*, 110 U. S. 347 (1884), (4 Sup. Ct. Rep. 48); *Greenwood v. Freight Co.*, 105 U. S. 13 (1881); *Sinking Fund Cases*, 99 U. S. 700 (1878); *Shields v. Ohio*, 95 U. S. 319 (1877).

<sup>5</sup> *Greenwood v. Freight Co.*, 105 U. S. 19 (1881).



to public policy and, consequently, void. But, in such a case, the unlawful purpose is the essential objection rather than the foreign domicile of the corporation, however much the latter fact, in the opinion of the court, may tend to aggravate the evil.<sup>1</sup>

These general principles, applicable to all foreign corporations holding stock in domestic companies, apply with equal force to foreign holding corporations, distinctively speaking. Holding corporations may acquire shares in corporations of other States unless the laws or policy of those States forbid. They cannot be used as a cover for evading those laws, or for the accomplishment of purposes contrary to public policy.<sup>2</sup>

**287. Incidents of Ownership attach to Intra Vires Holdings.** — A corporation, acting within the scope of its powers in acquiring the shares of other corporations, is entitled to all the privileges, and is subject to all the obligations, of a natural person as owner.

The right to vote is an incident to the ownership of stock, and whenever a corporation has power — express or implied

<sup>1</sup> In *Marble Co. v. Harvey*, 92 Tenn. 119 (1892), (20 S. W. Rep. 427, 36 Am. St. Rep. 71, 18 L. R. A. 252), Judge Lurton said: "The purpose and intent in granting a charter is, that the corporation shall carry on its business through its own agents, and not through the agency of another corporation. The public policy of this State will not permit the control of one corporation by another. Especially is this true where a foreign corporation thus undertakes to control and swallow up a domestic company. Such control of one corporation by another in a like business is unlawful, as tending to monopoly. The result is, that this purchase of shares for the express object of controlling and managing another corporation was *ultra vires*, and, therefore, unlawful and void."

A foreign corporation coming into a State is subject to the laws governing domestic corporations and can exercise no greater power to purchase

the control of other corporations than is conferred upon domestic corporations. And this is especially true where the purchase is made for the purpose of stifling competition.

*Dunbar v. American Telephone, etc. Co.*, 224 Ill. 25 (1906), (79 N. E. Rep. 423).

<sup>2</sup> In *Empire Mills v. Alston Grocery Co.* (Tex. App. 1891), 15 S. W. Rep. 506, the Court said: "No rule of comity will allow one State to charter corporations to operate in another State, unless there is a willingness on the part of the foreign State that it should do so. To hold otherwise would be to say that the right of one State, aided by comity, is superior to the sovereign will of the other. This involves the surrender of sovereignty to a rule of comity and to a matter of international etiquette, which no independent nationality should for a moment think of doing."

— to take title to shares of stock, it has the right, so long as it retains them, to exercise the voting power, — through an authorized agent, — upon which their value may depend.<sup>1</sup> All dividends declared upon the shares it holds belong to it, and it is entitled to have the stock transferred to its name upon the books of the corporation in which it is held.<sup>2</sup>

A corporation is liable for calls upon its authorized subscription contracts; and, as a stockholder, is subject to all the

<sup>1</sup> *Rogers v. Nashville, etc. R. Co.*, 91 Fed. 312 (1898); *Matthews v. Murchison*, 17 Fed. 760 (1883); *Davis v. United States Electric Power, etc. Co.*, 77 Md. 35 (1893), (25 Atl. Rep. 982); *Market St. R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225); *State v. Rohlfs* (N. J. 1890), 19 Atl. Rep. 1099; *Oelberman v. New York, etc. R. Co.*, 77 Hun (N. Y.), 332 (1894), (29 N. Y. Supp. 545). See also *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 428 (1904), (75 Pac. Rep. 89). That a *municipal* corporation, holding stock, may vote upon it as any other stockholder, see *Hancock v. Louisville, etc. R. Co.*, 145 U. S. 409 (1892), (12 Sup. Ct. Rep. 969).

A corporation holding stock in another corporation has the right — it is held — to vote such stock in favor of the dissolution of the corporation notwithstanding it thereby obtains the termination of a contract favorable to such corporation but burdensome to itself.

*Windmuller v. Standard Distilling, etc. Co.*, 114 Fed. 491 (1902), 115 Fed. 748 (1902). (These two cases are between the same parties but in different courts.)

A corporation owning stock in another corporation is an indispensable party to a suit to enjoin the voting of such stock at a stockholders' meeting.

*Taylor v. Southern Pac. Co.*, 122 Fed. 147 (1903).

In *State v. Newman*, 51 La. Ann.

833 (1899), (25 So. Rep. 408, 72 Am. St. Rep. 476), it was held that, even if a corporation had implied power to acquire and hold stock in another corporation, its right was that of "imperfect ownership" — including the right to enjoy and dispose of the shares, but not the right to vote them.

The phrase "imperfect ownership" aptly describes the rights of a corporation in respect of its *ultra vires* holdings, but when a corporation *has* power — express or implied — to hold stock, it necessarily must have the right to exercise the privilege which may give the stock its greatest value.

For case where right of corporation to hold stock was not questioned but its right to vote it was denied, see *Parsons v. Tacoma Smelting, etc. Co.* 25 Wash. 508 (1901), (65 Pac. Rep. 765).

Where a corporation having authority to acquire stocks purchased shares of another corporation and, as a part of the consideration, guaranteed certain dividends upon the outstanding stock of the latter company, it was held that its action was not *ultra vires* as constituting a guaranty of dividends whether earned or not, but would be enforced as an agreement to make stated payments at stated periods on account of the purchase price.

*Windmuller v. Standard Distilling, etc. Co.*, 94 N. Y. Supp. 52 (1905).

<sup>2</sup> *Royal Bank of India's Case*, L. R. 4 Ch. App. 252 (1869).

obligations of other stockholders, and is bound to pay all assessments lawfully made against its *intra vires* holdings of shares.<sup>1</sup> Its liability as a stockholder, for assessments for the benefit of creditors, is not affected by the fact that while it appears upon the stock books as *owner* it is, in reality, only a pledgee.<sup>2</sup> Nor will a merely colorable transfer relieve it from responsibility.<sup>3</sup>

§ 287a. **Collateral Trust Bonds.** — A corporation owning shares in other corporations has, manifestly, power to pledge them as security for its loans. In borrowing money upon such stock as collateral it will, in ordinary transactions, follow the same course as an individual.

But a corporation, having invested large sums of money in the purchase of interests in other corporations, is ordinarily desirous of using the stock purchased as security for bond issues. Such transactions cannot be carried out according to the ordinary course of business. The stock cannot be pledged to the individual bondholder. The funds cannot be obtained coterminously with the deposit of the collateral. A trustee

<sup>1</sup> *National Bank v. Case*, 99 U. S. 628 (1878); *Calumet Paper Co. v. Stotts Invest. Co.*, 96 Iowa, 147 (1895), (64 N. W. Rep. 782, 59 Am. St. Rep. 362); *Smith v. Newark, etc. R. Co.*, 8 Ohio Cir. Ct. Rep. 583 (1894); *Royal Bank of India's Case*, L. R. 4 Ch. App. 252 (1869).

<sup>2</sup> *National Bank v. Case*, 99 U. S. 631 (1878); "It is thoroughly established that one to whom stock has been transferred in pledge, or as collateral security for money loaned, and who appears on the books of the corporation as the owner of the stock, is liable as a stockholder for the benefit of creditors." See also *Pauly v. State Loan, etc. Co.*, 165 U. S. 606 (1897). (17 Sup. Ct. Rep. 465); *Pullman v. Upton*, 96 U. S. 328 (1877); *National Foundry, etc. Works v. Oconto Water Co.*, 68 Fed. 1006 (1895); *Ball Electric Light Co. v. Child*, 68 Conn. 522 (1897), (37 Atl. Rep. 391); *Calumet Paper Co. v. Stotts Invest. Co.*, 96 Iowa, 147

(1895), (64 N. W. Rep. 782, 59 Am. St. Rep. 362); *Royal Bank of India's Case*, L. R. 4 Ch. App. 252 (1869).

A pledgee is not, however, personally liable as a stockholder when the stocks stands in his name "as pledgee," or where he is registered as holding it as collateral. *Pauly v. State Loan, etc. Co.*, 165 U. S. 606 (1897), (17 Sup. Ct. Rep. 465); *Beal v. Essex Savings Bank*, 67 Fed. 816 (1895).

<sup>3</sup> *National Bank v. Case* 99 U. S. 628 (1878); *Bowden v. Johnson*, 107 U. S. 251 (1882), (2 Sup. Ct. Rep. 246).

But the pledgee, for the avowed purpose of avoiding individual liability, may take the security, in the first place, in the name of an irresponsible trustee. *Anderson v. Philadelphia Warehouse Co.*, 111 U. S. 479 (1883), (4 Sup. Ct. Rep. 525); also *Pauly v. State Loan, etc. Co.*, 165 U. S. 606 (1897), (17 Sup. Ct. Rep. 465).

must act in behalf of all the bondholders. The securities must be pledged before the bonds are certified to, and this must precede their issue and sale.

The method generally adopted, therefore, in case of such an issue of bonds is to execute a deed of trust conveying to a trustee — usually a trust company — the shares of stock to be held by it in trust for the benefit of the holders of the bonds, and prescribing the conditions under which the collateral is to be held, the procedure in case of default of payment and, generally, the rights and obligations of the pledgor corporation, the trustee and the bondholders. Upon the execution of the deed of trust the certificates for the stock pledged as collateral are delivered to the trustee, which may transfer them to its own name. The deed of trust may or may not contain an after-acquired property clause.<sup>1</sup>

<sup>1</sup> The following extract from the opinion of Judge Lacombe in *Park v. New York, etc. R. Co.*, 64 Fed. 192 (1894), in addition to the particular point decided, illustrates the nature and security of collateral trust bonds — the bonds in question being a comparatively early issue of bonds of that character :

*"The Collateral Trust Bonds.* In 1882 the defendant railroad, being the owner of stocks and bonds of various corporations, pledged them to the United States Trust Company as security for a series of bonds issued by defendant. The various stocks and bonds thus pledged were specifically enumerated in the indenture of mortgage, and they were delivered to the United States Trust Company, the railroad reserving the power of voting on such stocks and bonds, so as not to lose its control of the subsidiary corporations. In case of six months' default in payment of interest on the collateral trust bonds, the United States Trust Company was authorized to sell the pledged securities at public auction upon three months' notice. The amount of collateral trust bonds outstanding is

\$3,344,000. The par value of the stocks and bonds pledged for their payment is about \$8,000,000, and their actual value not less than three times the amount of collateral trust bonds outstanding. The pledged stocks and bonds are paying interest, annually, in excess of the interest due on the trust bonds by over \$50,000. It appears, moreover, that in some instances such pledged stocks secure to their owner the control of property which is, and has been for many years, an integral part of the Erie Railroad system. The anthracite coal lands and the bituminous coal lands are owned by corporations, the entire capital stock of which is included among the securities thus pledged. It is plain that if, upon default in the payment of the interest falling due on the collateral trust bonds, the trustee should, as the mortgage provides, declare the whole principal due, and sell the pledged securities in the open market to the highest bidder, the value of the property which was placed in the hands of these receivers to be conserved for the benefit of all the creditors would be most seriously impaired. Cer-

Bonds of this character are denominated collateral trust bonds and the deed of trust a collateral trust mortgage, and their use has developed with the development of corporate stockholding. But the development has been so recent that the decided cases illustrate comparatively few of the legal questions which may be expected to arise in connection with such bonds and mortgages.

Where, according to the provisions of the deed of trust, the pledgor corporation reserves to itself all the rights, powers and privileges appertaining to the ownership of the shares pledged, including the right to vote them, it may require from the trustee a proxy for voting the stock if transferred to its name. And it may even require such a proxy to vote for the merger of the corporation in which the stock is held with another corporation, although its effect will be to compel the trustee to receive back, in place of the stock originally pledged, shares in the consolidated company.<sup>1</sup>

Where a deed of trust provides that the voting power of the shares pledged shall, after default, be exercised by the trustee — the pledgor corporation having such right until such time — the trustee is not bound to vote according to the wishes of a majority of the bondholders but should exercise its judgment and discretion for the benefit of all the bondholders.<sup>2</sup>

A trustee of a collateral trust mortgage containing an after-acquired property clause is chargeable with notice of the lien attaching to such property when acquired, and such lien is superior to the lien of a subsequent pledge thereof to the trustee in its individual capacity. Thus, where a street railway corporation executed a deed of trust containing such a clause and the trustee certified to certain bonds to be used for purchasing the assets of a connecting road which, after their purchase, were transferred to a new corporation, all the stock of which was owned by the pledgor corporation which likewise had possession of the stock certificates, it was held that such stock in equity was subject to the deed of trust and that the trustee

tainly such a catastrophe should not be allowed to overtake the property while in the hands of the court."

<sup>1</sup> *Pennsylvania R. Co. v. Penn-*

*sylvania etc. Co.* 205 Pa. 219. (1903), (54 Atl. Rep. 783).

<sup>2</sup> *Toler v. East Tennessee, etc. R. Co.*, 67 Fed. 168 (1894).

did not secure a superior lien thereon by accepting a subsequent pledge thereof to secure a loan made by it individually to the pledgor corporation.<sup>1</sup>

Where a trustee received under a deed of trust certain shares of stock and subsequently agreed with the pledgor corporation that, upon the execution of certain mortgages, it would surrender the pledged stock, but although the mortgages were executed failed to transfer back the stock, it was held that the security of the deed of trust upon such stock was unimpaired.<sup>2</sup>

The acceptance by a trustee of a deed of trust covering shares of stock in no way prevents it from acting as trustee of a mortgage of the corporation in which such stock is held, notwithstanding that the foreclosure of the mortgage may render the stock valueless.<sup>3</sup>

A holder of bonds secured by a collateral trust mortgage cannot maintain a bill in equity for the removal of the trustee upon the ground of the failure of the directors of the corporations in which the pledged stock is held to perform the covenants contained in the deed of trust, in the absence of averments of knowledge of such failure on the part of the trustee and of a request for action by it. Moreover, such a suit cannot be maintained without sufficient reason being shown for dis-

<sup>1</sup> Guaranty Trust Co. v. Atlantic Coast Electric Co., 138 Fed. 517 (1905).

That a mortgage containing an after-acquired property clause covers stock in another corporation subsequently purchased by the mortgagor, see *Williamson v. New Jersey Southern R. Co.*, 26 N. J. Eq. 398 (1875).

See also *Central Trust Co. v. Kneeland*, 138 U. S. 414 (1890).

<sup>2</sup> *Blake v. Domestic Mfg. Co.*, 38 Atl. Rep. 242 (N. J. Ch. 1897).

<sup>3</sup> *Gasquet v. Fidelity Trust, etc. Co.*, 75 Fed. 343 (1896).

In this case a street railway company owned nearly all the stock of another street railway company operating in the same city, which company was also indebted to the former company. The officers and directors of

both companies were the same. The former company executed a mortgage upon all its property including the stock in the latter company to a trust company as trustee to secure an issue of bonds. Subsequently the second company executed a mortgage upon its property to the same trustee to secure a bond issue — the bonds being turned over to the first company which used them to secure an indebtedness of its own. The first company defaulted in its mortgage and the property and stock were sold for less than the amount of the bonds. Some of the bondholders alleged a breach of trust upon the part of the trustee in accepting the mortgage from the second company but the court held that the action of the trustee was entirely proper.

regarding the provisions of the deed of trust regarding the removal of a trustee and the appointment of another.<sup>1</sup>

A trustee of a collateral trust mortgage is a proper party to a suit to wind up the pledgor corporation as insolvent and may intervene in such a suit for the protection of its trust when it has been ordered to turn over the securities pledged in the deed of trust to a receiver of the pledgor corporation. And its right to take such step is not affected by the fact that there has been no default upon the bonds secured by the trust deed.<sup>2</sup>

Where a collateral trust mortgage provides that after default in an interest payment the trustee may, and upon the request of the holders of a majority of the bonds shall, declare the principal due and payable, and may, and upon like request shall, proceed to sell the pledged stock at public auction but that the bondholders may revoke their requests in which case the trustee shall not make such sale, it is held that the provisions apply only to the exercise of the power of summary sale contained in the collateral trust mortgage, and that a suit to foreclose such mortgage for default in interest may be maintained in opposition to the majority of the bondholders.<sup>3</sup>

## II. *Ultra Vires Holdings*

§ 288. **What Incidents of Ownership attach to Ultra Vires Holdings.** — When a corporation, without authority, purchases the shares of another corporation, the law recognizes a limited right of ownership therein. Otherwise, the purchase

<sup>1</sup> Dillaway v. Boston Gas Light Co., 174 Mass. 80 (1899), (54 N.E. Rep. 359).

<sup>2</sup> Miles v. New South Building, etc. Ass'n, 99 Fed. 4 (1900).

<sup>3</sup> Toler v. East Tennessee, etc. R. Co., 67 Fed. 169 (1894).

In this case it was also held that the answer of a majority of the bondholders on the foreclosure suit that the value of the pledged stock was abnormally depressed; that there was good ground for anticipating a considerable enhancement in its value,

and that the complainants were bringing the suit in the interests of a rival railroad company which desired to purchase the stock at the depressed price, presented no defence to the foreclosure.

For consideration of collateral trust bonds issued by a holding corporation to obtain working capital for the corporations in which it held controlling interests, and the rights and obligations of the several corporations see Dittman v. Distilling Co. (N. J. Ch. 1903), 54 Atl. Rep. 570.

would involve a forfeiture of the consideration paid for the stock. A corporation is entitled to receive the dividends declared upon its *ultra vires* holdings, and has a right to sell and dispose of such shares.<sup>1</sup>

Such a corporation, however, is not entitled to participate in the control and management of the corporation in which it so acquires stock. It is not entitled to vote, and other stockholders may enjoin it from voting should it attempt to do so.<sup>2</sup>

It has also been held that a corporation acquiring, without authority, stock in another corporation cannot compel the latter corporation to transfer the shares upon the stock books so as to give it the *status* and privileges of a stockholder of record.<sup>3</sup>

§ 288a. **Status of Parties to Ultra Vires Purchases of Stock.**—It has been said in opinions of the highest authority that a transfer of stock to a corporation which it has no power to take is an absolute nullity and wholly void. Upon this ground, it is held that such a transfer affects in no way the *status* of the transferrer of the stock, and that he remains subject to all liabilities attaching to stockholders after the transfer as before.<sup>4</sup>

<sup>1</sup> *Milbank v. New York, etc. R. Co.*, 64 How. Pr. 20 (1882); *State v. Newman*, 51 La. Ann. 833 (1899), (25 So. Rep. 408, 72 Am. St. Rep. 476).

Where one corporation acquires stock in another company, and the contract is fully executed, the latter cannot set up the defence of *ultra vires* to an action for the recovery of dividends. *Bigbee, etc. Packet Co. v. Moore*, 121 Ala. 379 (1898), (25 So. Rep. 602).

<sup>2</sup> *Milbank v. New York, etc. R. Co.*, 64 How. Pr. 20 (1882); *State v. Newman*, 51 La. Ann. 833 (1899), (25 So. Rep. 408, 72 Am. St. Rep. 476). See also *Parsons v. Tacoma Smelting, etc. Co.*, 25 Wash. 508 (1901), (65 Pac. Rep. 765).

In *State v. McDaniel*, 22 Ohio St. 354 (1872), there is a *dictum* to the effect that a railroad company acquiring, without authority, bonds of an-

other railroad company having voting power, cannot vote them.

<sup>3</sup> *Franklin Bank v. Commercial Bank*, 36 Ohio St. 350 (1881), (38 Am. Rep. 594). While this decision is undoubtedly correct upon the point stated, it is manifestly erroneous in the *dictum* that the taking of shares by way of pledge is *ultra vires*. See *ante*, § 278: "*Incidental Power to take Stock as Collateral.*"

<sup>4</sup> In *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 738 (1904), the Court said: "Defendants' transfer of their stock in the Kansas Company was a nullity. Nothing done in pursuance of the transfer, no acquiescence therein, and no receipt of benefits therefrom, could infuse validity into that act, or prevent the successful assertion of its nullity. The claimed estoppel is not tenable. The liability for the corporate debts, with which the holders of the Kansas



And upon the same ground, as we shall see, it is held that the transferee corporation is not liable for assessments upon its *ultra vires* holdings.

But is it believed that these opinions go too far — that the same conclusions may be reached upon narrower grounds. The *ultra vires* acquisition of stock by a corporation is not a nullity. As already shown, the law recognizes a limited right of ownership in such stock on the part of the corporation. The corporation may sell the stock and pass good title to the purchaser. The *ultra vires* act in making the purchase does not affect the legality of the sale. None of these results could follow if the acquisition by the corporation were wholly void. The corporation could take nothing by that which was a nullity.

The correct rule would seem to be that an *ultra vires* purchase of stock is a nullity only in so far as relates to the *status* of the parties to the transaction as stockholders of the corporation in which the stock is held. The stockholders of a corporation — entitled to the privileges and subject to the obligations attaching to stockholders — can only be persons or corporations capable of holding the stock. When a corporation, acting beyond its powers, takes stock it acquires a limited ownership therein but does not become a stockholder and is not subject to a stockholder's liabilities. The vendor, on the other hand, although he has parted with the practical ownership of the stock continues liable as stockholder because no one competent to occupy that position has succeeded him. But when the corporation has sold its *ultra vires* holdings to a person or corporation authorized to take and hold them, the latter becomes

Company's stock were charged, under the Constitution and laws of Kansas, was not extinguished or discharged by the transfer. That liability did not pass to the Missouri Company, because it could not, and therefore did not, become a stockholder in the Kansas Company. It follows that defendants continued to be stockholders in the Kansas Company, and remained liable for the corporate debts in like manner as if the transfer had never occurred."

A subscriber for stock in a corporation which is not authorized to hold stock in other corporations, who turns over in payment of his subscription the stock of another corporation, remains liable for the full amount of his subscription, less the proceeds of the sale of such stock received by the corporation.

Lester v. Bemis Lumber Co., 71 Ark. 379 (1903), (74 S. W. Rep. 518).

a stockholder in the corporation and succeeds the original vendor as such.

§ 289. **Liability for Assessments upon Ultra Vires Holdings.** — When a subscription by one corporation for stock in another is without authority, it is void, and the corporation is not liable for calls or assessments made upon stockholders, because it is not a stockholder.<sup>1</sup> Upon similar principles, a corporation which purchases, or otherwise acquires, shares of another corporation cannot be assessed or held liable as a stockholder, when, in taking the stock, it acted beyond its powers.<sup>2</sup> Obligations of this nature are not incurred by *ultra vires* acts.

A distinction has, however, been drawn between cases where the acquisition of stock is wholly beyond the powers of the corporation and cases where it is only partially so. Thus, it has been held that the fact that a corporation *might*, under certain circumstances, have acquired stock in another corporation, renders its purchase, for any other purpose, merely the unauthorized exercise of an existing power and estops it, when the corporation becomes insolvent, from setting up the defence of *ultra vires* to an action to enforce an assessment upon the stock.<sup>3</sup> Such an exception is, however, as broad as

<sup>1</sup> *Peshtigo Co. v. Great Western Tel. Co.*, 50 Ill. App. 624 (1893); *Pauly v. Coronado Beach Co.*, 56 Fed. 428 (1893).

A lien of a corporation on its stock, for debts due from its stockholders, does not attach to the *ultra vires* holdings of another corporation. *Lanier Lumber Co. v. Rees*, 103 Ala. 622 (1894), (16 So. Rep. 637, 49 Am. St. Rep. 57).

<sup>2</sup> *California Bank v. Kennedy*, 167 U. S. 362 (1897), (17 Sup. Ct. Rep. 831). In *ex parte* British Nation Life Assurance Ass'n, L. R. 8 Ch. 679 (1878), the Court of Appeal dismissed an order putting a life association on the list of contributories to a corporation in liquidation because certain shares of such corporation had been transferred to it. Lord Justice James held that, while the association was

empowered to purchase for investment shares of a certain character, it was not empowered to purchase stock which would practically constitute it a partner in a business venture, and that the transfer of the stock in question into the name of the association was *ultra vires* and void.

<sup>3</sup> A State bank having, under its charter, power to accept stock in a national bank as security for a loan, but without power to purchase such stock as an investment, purchased stock in a national bank, which was transferred to its name. The latter bank subsequently became insolvent, and an assessment upon the stockholders was made by a comptroller of the currency, payment of which was resisted by the State bank on the ground that the purchase was *ultra*

the rule, for there are circumstances under which every corporation, unless expressly prohibited, may acquire stock. The distinction is not well founded upon principle and is opposed to the latest decisions of the Supreme Court of the United States.

In *California Bank v. Kennedy*<sup>1</sup> Mr. Justice White said: "*The transfer of the stock in question to the bank being unauthorized by law, does the fact that, under some circumstances, the bank might have legally acquired stock in the corporation, estop the bank from setting up the illegality of the transaction?*" Whatever divergence of opinion may arise on this question from conflicting adjudications in some of the State courts, in this Court it is settled in favor of the right of the corporation to plead its want of power, that is to say, to assert the nullity of an act which is an *ultra vires* act. . . . The power to purchase or deal in stocks of another corporation, as we have said, is not expressly conferred upon national banks, nor is it an act which may be exercised as incidental to the powers expressly conferred. A dealing in stocks is, consequently, an *ultra vires* act. Being such, it is without efficacy. . . . Stock so acquired creates no liability to the creditors of the corporation whose stock was attempted to be transferred."<sup>2</sup>

*vires*. It was held that, as the purchase of stock was merely the exercise, for an unauthorized purpose, of a power existing for a legitimate purpose, such defence was not available. *Citizens State Bank v. Hawkins*, 71 Fed. 369 (1896).

In *First National Bank v. Hawkins*, 79 Fed. 51 (1897), it was held that a national bank, which had purchased shares of stock in another national bank as an investment, and which appeared on the books of the latter bank as a stockholder, was estopped, after the insolvency of the latter, from denying liability for an assessment on the stock, on the ground that its purchase was *ultra vires*. The decision in this case was rendered a few weeks before the decision of the Supreme Court of the United States, in *California Bank v. Kennedy*, 167

U. S. 362 (1897), (17 Sup. Ct. Rep. 831), *infra*, and it was subsequently reversed by the Supreme Court (*Concord National Bank v. Hawkins*, 174 U. S. 364 (1899), (19 Sup. Ct. Rep. 739)).

<sup>1</sup> *California Bank v. Kennedy*, 167 U. S. 367 (1897), (17 Sup. Ct. Rep. 831), *reversing Kennedy v. California Sav. Bank*, 101 Cal. 495 (1893), (35 Pac. Rep. 1039).

<sup>2</sup> In *Robinson v. Southern Nat. Bank*, 180 U. S. 309 (1900), (21 Sup. Ct. Rep. 383) the Supreme Court said: "This court has held in *California Bank v. Kennedy*, 167 U. S. 362 (1897), (17 Sup. Ct. Rep. 831) and *Concord National Bank v. Hawkins*, 174 U. S. 364 (1899), (19 Sup. Ct. Rep. 739) that it is not competent for national banking associations to invest any portion of their

Where, under the laws of a State, a judgment against a corporation holding it liable for an assessment as a stockholder in another corporation is conclusive upon its stockholders as to such liability, a stockholder, when sued upon such a judg-

capital permanently in the stocks of another corporation and that they are not estopped from setting up such want of power against suits to enforce liability for assessments made by the Comptroller of the Currency. While not disposed, as at present advised, to push the principle of these cases so far as to exempt such banks from liability as other shareholders when they have accepted and hold stock of other corporations as collateral security for money advanced (a proposition which we withhold from decision) we think there is a presumption in such cases against any intention on the part of the lending bank to become the owner of the collateral shares."

See also *Chemical Nat. Bank v. Havemeyer*, 120 Cal. 601 (1898), (52 Pac. Rep. 1071, 65 Am. St. Rep. 206); *Schofield v. Goodrich Bros. Co.*, 98 Fed. 273 (1899).

In *Hunt v. Hauser Malt Co.*, 90 Minn. 282 (1903), (96 N. W. Rep. 85) the Supreme Court of Minnesota declined to follow the decision in *California Bank v. Kennedy*, *supra*. The Court said that while as a State court it was bound by the decisions of the Supreme Court of the United States as to the power of national banks, it was not bound to apply such decisions to State banks when they were not in accord with State decisions. And in this case it was held that a malting company which had purchased and held bank stock as an investment and had received dividends for several years was estopped to assert its *ultra vires* act in acquiring such stock in a suit to enforce a stockholder's liability under the Minnesota laws, brought by a receiver of the bank which had become

insolvent. In the same case, 95 Minn. 206 (1905), (103 N. W. Rep. 1032), the Court adhered to its previous decision.

In *Fidelity Ins. Co. v. German Sav. Bank*, 127 Iowa, 591 (1905), (103 N. W. Rep. 958) the Supreme Court of Iowa distinguished *California Bank v. Kennedy*, *supra*, and held that while the Iowa statutes did not authorize an insurance company to invest its funds in the purchase of bank stock yet that such investment was not expressly prohibited and the insurance company could not claim that it was *ultra vires* after having received the benefits of the transaction. The Court said (p. 596): "Counsel for appellant take the broad ground, however, that the acquisition of this stock by the plaintiff company in the defendant bank was *ultra vires*, and therefore illegal and void, and that plaintiff may entirely disregard it, and recover from the defendant the balance of plaintiff's deposit in the old bank; and we shall proceed to consider the soundness of this contention. It is claimed that the act of the plaintiff company in acquiring stock in the defendant bank was *ultra vires*, because it was outside the scope of the plaintiff's business as an insurance company, and prohibited by statute. As to the claim that this acquisition of stock was outside of the general scope of plaintiff's business, it is sufficient to say that a corporation cannot repudiate an executed contract of which it has received the benefit on the ground that such contract is *ultra vires* that is, not within the scope of the business which is it authorized to transact."

ment in another jurisdiction to enforce his statutory liability, cannot set up as a defence the want of power of the former corporation to hold stock in the latter.<sup>1</sup>

§ 290. **Ultra Vires Contracts for Purchase of Stock. Who may question Validity of Ultra Vires Purchases. — Dependent Contracts.** — A contract entered into by a corporation for the purchase of stock in another corporation, which it has no authority to acquire, is invalid. No recovery can be had upon it and the defence of *ultra vires* is equally available to the corporation and to the other contracting party.<sup>2</sup>

The right of a corporation to hold stock in other corporations cannot, however, be the subject of collateral attack by third persons. Thus, a subscriber for stock in a corporation cannot set up as a defence to an action upon his subscription contract that other subscriptions have been made by corporations — it not being shown that such corporations have in any way failed to fulfil their obligations.<sup>3</sup> So the question whether a railroad company, in violation of a State constitutional provision, holds control of a coal company cannot be raised collaterally in a suit for the specific performance of a contract.<sup>4</sup> And a creditor attaching stock standing in the name of his debtor — an individual — cannot raise against the equitable owner of the stock — a corporation — the objection that it has no right to own stock in other corporations.<sup>5</sup> An officer of a corporation who wrongfully conveys its property in exchange for stock of another corporation, taking such stock in his own name, will hold it in trust for the corporation and cannot set up that the corporation has no power to hold such stock.<sup>6</sup>

Contracts collateral to, and dependent upon, an *ultra vires*

<sup>1</sup> *Martin v. Wilson*, 120 Fed. 202 (1903) — Circuit Court of Appeals, Seventh Circuit.

<sup>2</sup> *De la Vergne Refrigerating Mach. Co. v. German Savings Inst.*, 175 U. S. 40 (1899), (20 Sup. Ct. Rep. 20).

<sup>3</sup> *McCoy v. World's Columbian Exposition*, 186 Ill. 356 (1900), (93 N. W. Rep. 225).

<sup>4</sup> *Hill v. Rich Hill Coal Min. Co.*,

119 Mo. 9 (1893), (24 S. W. Rep. 223).

<sup>5</sup> *Kern v. Day*, 45 La. Ann. 71 (1893), (12 So. Rep. 6).

<sup>6</sup> *Bear River Valley Orchard Co., v. Hanley*, 15 Utah 508 (1897), (50 Pac. Rep. 611).

See also *Manchester St. R. Co. v. Williams*, 71 N. H. 312 (1902), (52 Atl. Rep. 461).

contract for the purchase of stock cannot be enforced.<sup>1</sup> Thus, where a corporation purchased stock in another company and the vendor, as a part of the consideration, agreed to assume certain indebtedness of the corporation whose stock was transferred, it was held that an action upon this agreement was in furtherance of the original unlawful contract and could not be sustained.<sup>2</sup>

§ 291. **Independent Contracts.** — Although a contract by one corporation to purchase stock in another is *ultra vires* and cannot be enforced between the parties, yet when it has been executed and negotiable instruments have been given in payment of the purchase price, a *bona fide* holder for value, without notice of the illegality, may collect them from the

<sup>1</sup> *Marble Co. v. Harvey*, 92 Tenn. 115 (1892), (20 S. W. Rep. 427, 36 Am. St. Rep. 71, 18 L. R. A. 252).

An agreement between the officers of a bank and the maker of a note payable to it, that the note may be paid by the transfer to the bank of stock of another bank, is illegal. *Tillinghast v. Carr*, 82 Fed. 298 (1897).

Where an *ultra vires* contract for the purchase of stock by a corporation has been executed, and a note given in payment, equity will not intervene to cancel the agreement, but will leave the corporation to its legal defence to the note. *Cincinnati, etc. R. Co. v. McKeen*, 64 Fed. 36 (1894).

<sup>2</sup> *Marble Co. v. Harvey*, 92 Tenn. 115 (1892), (20 S. W. Rep. 427, 36 Am. St. Rep. 71, 18 L. R. A. 252).

In this case Judge Lurton, after referring to cases where *ultra vires* had not been permitted as a defence, or as a ground for collateral attack, said: "The question here is not like any of these. The complainant sues upon its contract, and, in affirmation of it, seeks to have the defendant perform an arrangement which sprung from and was collateral to it. It has

received the shares it purchased, and holds on to them. It simply asks that the defendant be further compelled to perform his contract by contributing, in accordance with his agreement, his proportion of the liability paid off by the complainant in protection of the property of the McMillan Marble Company. The suit is clearly in furtherance of the original unlawful and void contract. That the contract has been executed by the plaintiff does not make it lawful or entitle it to an enforcement of it." The judge then referred at length to *Pittsburgh, etc. R. Co. v. Keokuk, etc. Bridge Co.*, 131 U. S. 389 (1889), (9 Sup. Ct. Rep. 770), and *Central Transportation Co. v. Pullman Car Co.*, 139 U. S. 24 (1891), (11 Sup. Ct. Rep. 478), and continued (p. 124): "To sustain this suit, as now presented, would be in affirmation and furtherance of an unlawful and void contract. It is, in no sense, a suit in disaffirmance. Whether complainant could tender back the shares received, and maintain a suit to recover the money paid for the shares upon an implied agreement to return money which the defendant had no right to retain, is a question not presented upon this record."

corporation.<sup>1</sup> But such a holder has only the right to demand payment of his note, and has no standing to compel the rescission of the contract of purchase on the ground that it was *ultra vires*.<sup>2</sup>

Independent contracts made by a corporation, although relating to stock held without authority, are not necessarily tainted with the original illegality. It does not follow that it is illegal to dispose of stock because it was unlawful to acquire it in the first instance.<sup>3</sup> Upon this principle, it has been held that a purchaser of stock from a corporation, giving a note in payment therefor, cannot set up *ultra vires* as a defence to an action upon the note. In *Holmes, etc. Manufacturing Co. v. Holmes, etc. Metal Co.* the Court of Appeals of New York said: <sup>4</sup> "The contract under which the note in suit was given was made . . . nearly four years after the plaintiff became the owner of the stock. No claim is made that that contract is, for any

<sup>1</sup> In *Woodcock v. First National Bank*, 113 Mich. 236 (1897), (71 N. W. Rep. 477), where a note and mortgage had been given in payment for an *ultra vires* purchase of stock, the Supreme Court of Michigan said: "If the complainant was not aware of an infirmity in these securities in the hands of the First National Bank, as the paper was not dishonored when received by complainant, and was negotiated by the officers of the gas light company, the security could not be defeated in complainant's hands."

In *Wright v. Pipe Line Co.*, 101 Pa. St. 204 (1882), (47 Am. Rep. 701), where a corporation, although prohibited by its charter, entered into a contract for the purchase of stock in another corporation, which was executed and a note given in payment, which was acquired by a *bona fide* purchaser for value, but *with knowledge of the character of the consideration*, it was held that the corporation could not set up the defence of *ultra vires* to the note.

The purchase by a trust company, authorized to acquire the shares of

other corporations, of the stock of a ferry company in behalf of a foreign railroad company as an undisclosed principal is not, between the parties thereto, rendered invalid by reason of the lack of power of the railroad company to legally hold the stock.

*Newman v. Mercantile Trust Co.*, 189 Mo. 423 (1905), (88 S. W. Rep. 6).

<sup>2</sup> *Woodcock v. First National Bank*, 113 Mich. 236 (1897), (71 N. W. Rep. 477).

<sup>3</sup> *Bigbee, etc. Packet Co. v. Moore*, 121 Ala. 379 (1898), (25 So. Rep. 602). In this case it was held that it was immaterial in a suit by a *transferee* of stock that the transferrer — a corporation — acted beyond its powers in acquiring the stock.

A corporation having sold its property and received the purchasing corporation's stock in payment, cannot be enjoined by the latter from transferring the stock. *American Water Works Co. v. Venner*, 63 Hun, 632 (1892), (18 N. Y. Supp. 379).

<sup>4</sup> *Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co.*, 127 N. Y. 260 (1891), (27 N. E. Rep. 831, 24 Am. St. Rep. 448).

reason, illegal or void. Numerous cases are found in which the courts have refused to execute contracts that were *ultra vires*, but this action is not based upon such contract. . . . To hold that the plaintiff could not dispose of the stock would deprive it of the consideration received for the transfer of its rolling mill and material, thus accomplishing a wrong and not advancing justice."

§ 292. **Holding Stock to prevent Competition.** — While the purchase of stock in any other corporation is beyond the general powers of a corporation, the purchase of stock in a competing corporation in order to prevent competition, is not only *ultra vires* but is contrary to public policy.<sup>1</sup>

The rule of public policy is not to be evaded by indirection.

<sup>1</sup> *United States*: Louisville, etc. R. Co. v. Kentucky, 161 U. S. 698 (1896), (16 Sup. Ct. Rep. 714): "Not only is the purchase of stock in another company beyond the power of a railroad corporation in the absence of an express stipulation in the charter, but the purchase of such stock in a rival and competing line is held to be contrary to public policy and void." See also *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787 (1896).

*Georgia*: Central, etc. R. Co. v. Collins, 40 Ga. 582 (1869); *Hazlehurst v. Savannah, etc. R. Co.*, 43 Ga. 13 (1871).

*Illinois*: *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497). This is the leading case upon the subject. See also *Dunbar v. American Telephone, etc. Co.*, 224 Ill. 9 (1906), (79 N. E. Rep. 423).

*New Hampshire*: *Pearson v. Concord R. Corp.*, 62 N. H. 537 (1883), (13 Am. St. Rep. 590).

*New Jersey*: *Elkins v. Camden, etc. R. Co.*, 36 N. J. Eq. 5 (1882).

*Pennsylvania*: *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 374.

*Tennessee*: *Marble Co. v. Harvey,*

92 Tenn. 115 (1892), (20 S. W. Rep. 427, 36 Am. St. Rep. 71, 18 L. R. A. 252).

*Compare Ellerman v. Chicago Junction R., etc. Co.*, 49 N. J. Eq. 217 (1891), (23 Atl. Rep. 287) where the Court said: "The corporate business of the Junction Company being to deal in stock of the Transit Company, and to do anything authorized by its charter to increase its value, and being, as above, authorized to buy the stock of any corporation, the buying of the stock of an intended rival, with the probable intent to use the purchase for the extension of the Transit Company's business, and with the certain effect of preventing the depreciation of that company's stock, is certainly within the powers contemplated by the certificate of the Junction Company."

*Compare, also, Rafferty v. Buffalo City Gas Co.*, 49 App. Div. (N. Y.) 618 (1899), (56 N. Y. Supp. 288) where it was held that a gas company having, under its charter, authority to acquire and hold the stocks of other corporations, had power to purchase the stocks of a company owning a franchise which if operated adversely to the former company might be ruinous to its business.



The fact that the stock is purchased in the name of another person or corporation for the benefit of the competing corporation does not affect its application.<sup>1</sup>

This subject is considered at length in the following part of this treatise.<sup>2</sup>

§ 293. **Remedies in Case of Ultra Vires Stockholding.** — Every stockholder in a corporation may stand upon his rights as secured by the contract of association. He cannot be forced into an outside enterprise, and may insist that the funds of the corporation shall be used only for the purposes permitted by its charter and the laws governing it.

Upon these principles, any stockholder in a corporation proposing, without authority, to purchase stock in another corporation may enjoin the purchase;<sup>3</sup> and it has been held that the fact that he obtains his stock after the passage of the resolution authorizing the purchase and with the purpose of preventing its consummation makes no difference.<sup>4</sup> It does not, however, follow, conversely to this proposition, that a stockholder in the corporation whose stock is acquired by

<sup>1</sup> *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 374.

In *Dunbar v. American Telephone, etc. Co.*, 224 Ill. 25 (1906), (79 N. E. Rep. 423) the Supreme Court of Illinois said: "These authorities fully sustain the position that the purchase by the American Company, either in its own name or in the names of others, of the majority stock of the Kellogg Company with the purpose and intent of controlling the latter and putting it out of business as a competitor of the American Company . . . was an attempt to exercise a power which it did not have. To permit it to do so would be against the law of this State and its public policy."

The Court in this case also held that the transaction was not a mere exercise of an excess of power and voidable, but that it was against public policy and wholly void.

<sup>2</sup> *Post*, Part V.: "*Combinations of Corporations.*"

<sup>3</sup> *Central, etc. R. Co. v. Collins*, 40 Ga. 582 (1869); *Memphis, etc. R. Co. v. Wood*, 88 Ala. 630 (1889), (7 So. Rep. 108); *Elkins v. Camden, etc. R. Co.*, 36 N. J. Eq. 5 (1882); *Solomons v. Laing*, 12 Beav. 339 (1849).

For case where bill of a dissenting stockholder to restrain the purchase by his corporation of stock in other corporations upon the ground that price was grossly excessive was denied see *Geer v. Amalgamated Copper Co.*, 48 Atl. Rep. 159, (N. J. Ch. 1901).

<sup>4</sup> In *Elkins v. Camden, etc. R. Co.*, 36 N. J. Eq. 5 (1882), the directors of a railroad company, without any statutory authority, passed a resolution to buy the stock of a competing road, and it was held:

(A) That the proposed purchase was *ultra vires*, and hence could not be executed if ratified by stockholders.

(B) That it was void and against public policy, in that its object was to prevent lawful competition.

another company can raise the objection of *ultra vires*. The purchase is beyond the powers, not of his corporation, but of the purchaser.<sup>1</sup>

Irrespective of the question of *ultra vires*, however, minority stockholders of a corporation are entitled to relief in equity against the acquisition of controlling stock interests in their corporation by a competing corporation for the purpose of eliminating competition and creating a monopoly.<sup>2</sup>

The laches of a stockholder in taking steps to prevent the *ultra vires* holding by his corporation of stock in another company may bar him from relief in equity.<sup>3</sup>

(C) That it could be enjoined upon application of a single stockholder of the purchasing company, and the fact that he obtained his stock after the passage of the resolution, and with avowed design of preventing its consummation, made no difference.

<sup>1</sup> Oelbermann v. New York, etc. R. Co., 77 Hun (N. Y.), 332 (1894), (29 N. Y. Supp. 545).

<sup>2</sup> In Dunbar v. American Telephone, etc. Co., 224 Ill. 29 (1906), (79 N. E. Rep. 423) the Court said: "But aside from the question as to whether the contract of purchase was *ultra vires* in the sense that the contract became a nullity, we think that such equitable rights are shown in the complainants, though minority stockholders, as ought to entitle them to maintain this bill. It is alleged in the bill, and admitted by the demurrer, that in order to stifle competition in trade and create a monopoly in itself and its licensee company, and for the purpose of enabling it to secure and maintain unreasonable and excessive rates and charges, said American Company conceived the illegal purpose of acquiring at least two-thirds of the stock of said Kellogg Company, and through such ownership to select and maintain a board of directors which should act in the real interests of and subservient to the American Company and free that

company and its licensee from the competition of the Kellogg Company and independent exchanges; also, that its ultimate purpose was to injure and finally destroy the Kellogg Company. That such conduct on the part of the American Company was fraudulent as against the stockholders of the Kellogg Company cannot be denied, and against which, on the plainest principles of equity, a stockholder in the Kellogg Company should have the right to relief."

A bill filed by a stockholder of a corporation to restrain it from permitting certain shares of its stock, alleged to be held by another corporation in violation of law, to be voted by such corporation or on its behalf, cannot be maintained where neither the latter corporation nor its receiver is made a party defendant.

Hollifield v. Wrightsville, etc. R. Co., 99 Ga. 365 (1896), (27 S. E. Rep. 715).

<sup>3</sup> Alexander v. Searcy, 81 Ga. 536 (1888), (8 S. E. Rep. 630, 12 Am. St. Rep. 337).

A purchase of stock in a corporation, with knowledge that it assumes and exercises the power to hold stock in other corporations, may amount to an implied recognition of the assumed power. Venner v. Atchison, etc. R. Co., 28 Fed. 581 (1886). This decision is contrary to sound prin-

The State may institute proceedings to prevent corporations from exceeding their chartered powers in purchasing shares in other companies. This is especially true in the case of corporations serving public purposes. An injunction may be granted in behalf of the State to restrain an unlawful acquisition or holding of stock;<sup>1</sup> and proceedings in *quo warranto* will lie against the corporation usurping the power.<sup>2</sup>

ciple. Laches may bar a stockholder in equity, but his recognition of, or acquiescence in, an *ultra vires* act cannot validate it.

In *McCampbell v. Fountain Head R. Co.*, 111 Tenn. 55 (1903), (77, S. W. Rep. 1073, 102 Am. St. Rep. 731), however, the Court said: "From the facts already stated, we have here a case where the parties complaining, by their active coöperation with all the other stockholders of the railroad company, brought about the *ultra vires* complication from which they now seek to be relieved. Will their complaint be listened to? In Green's *Brice's Ultra Vires*, p. 783, mere acquiescence in unauthorized and illegal transactions will be, it is said, sufficient to repel complaining stockholders. That author uses these words: 'If an act be *ultra vires*, a corporation may raise the objection, whether against a corporation or against a creditor or other contracting party attempting to enforce such act, or his alleged claims or rights resulting therefrom. But if an incorporator desire protection against the party who has thus dealt with the corporation, he must have been prompt and energetic in repudiating the transaction, as he can be bound by acquiescence. So, if he do not quickly object, and give his objection vitality, the creditor

will be justified in answering that he consents.'"

In a suit in equity by a stockholder to set aside an *ultra vires* purchase of stock made by the directors nine years before, it was held that the complainant was guilty of laches, and, therefore, was not entitled to relief. *Cullen v. Coal Creek, etc. R. Co.* (Tenn. 1897), 42 S. W. Rep. 693.

<sup>1</sup> *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368.

Delay does not affect the right of the State to prevent an *ultra vires* holding of stock. *Alexander v. Searcy*, 81 Ga. 536 (1888), (8 S. E. Rep. 630, 12 Am. St. Rep. 337).

<sup>2</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497).

Where a bank purchased stock in other corporations in violation of its charter and the statutes of the State but, upon the demand of the Secretary of State, immediately disposed of such holdings, it was held that such violations of the law under the circumstances were not ground for the appointment of a receiver to wind up the bank in an action by the State.

*State v. Peoples' United States Bank*, 197 Mo. 574 (1906), (94 S. W. Rep. 953).

## CHAPTER XXVII

## CONTROL OF ONE CORPORATION BY ANOTHER

- § 294. Meaning of Term "Control."
- § 295. Distinction between Control of Corporation and Control of its Property.
- § 296. Distinction between Control and Community of Interest.
- § 297. Distinction between Control and Consolidation.
- § 298. Power to purchase Stock to obtain Control.
- § 299. *Status* of Corporation as Controlling Stockholder.
- § 300. Trust Relation of Controlling Corporation to Minority Stockholders.
- § 301. Remedies of Minority Stockholders of Controlled Corporation.

§ 294. **Meaning of Term "Control."** — The control of a corporation has two phases. The ultimate power of control always lies in the stockholders. They determine, directly, matters of fundamental importance. They provide, through the election of directors, for the corporate management, and may thereby settle the corporate policy. The immediate power of control lies in the directors and officers appointed to manage the affairs of the corporation.<sup>1</sup>

The term "control," as applied to a corporation in its relations with other corporations — as distinguished from its internal management — refers to the ultimate power of control and means, specifically, the ownership of a *controlling interest* in a corporation. A corporation which owns a majority of the shares of the capital stock of another corporation controls it.<sup>2</sup>

<sup>1</sup> In *Pullman Car Co. v. Missouri Pac. R. Co.*, 11 Fed. 636 (1882), (*affirmed* 115 U. S. 587 (1885), (6 Sup. Ct. Rep. 194)), Judge McCrary said: "What are we to understand by the word 'control' as employed in the contract? The language is, 'all roads which it controls or may hereafter control,' which in our judgment means controlled by the corporation. The language does not refer to the ultimate power of control which always lies in the stockholders, and which may be indirectly exercised by them at stated periods by the election of directors. It means the immediate

or executive control which is exercised by the officers and agents chosen by and acting under the direction of the board of directors."

*Yazoo, etc. R. Co. v. Searles*, 85 Miss. 520 (1905), (37 So. Rep. 939, 68 L. R. A. 715): "'Control' of the business of a corporation . means power to dictate the corporate action of the corporation, not the mere management of some special limited department of its operations."

<sup>2</sup> *Jessup v. Illinois Cent. R. Co.*, 36 Fed. 741 (1888): "The bill charges that the Illinois Central Railroad Company has obtained control of the

§ 295. **Distinction between Control of Corporation and Control of its Property.** — A distinction, analogous to that between the ultimate and immediate control of the affairs of a corporation, exists between the control, by a corporation, of its property, and the control, by majority stockholders, of the corporation.

The owner of shares in a corporation does not own the corporate property. The holders of controlling stock interests control the corporation, the corporation controls its property.<sup>1</sup> In *Pullman Car Co. v. Missouri Pacific R. Co.*<sup>2</sup> Mr. Chief Justice Waite said: "It has all the advantages of

stock of the Dubuque and Sioux City Railroad Company. This allegation, upon the familiar rule that statements of this character will be taken most strongly against the pleader, only implies that the Illinois Central Railroad Company has obtained a majority of the stock of the Dubuque & Sioux City Railroad Company."

<sup>1</sup> *Pullman Car Co. v. Missouri Pac. R. Co.*, 115 U. S. 587 (1885), (6 Sup. Ct. Rep. 194), *affirming* 11 Fed. 636 (1882).

In *Fitzgerald v. Missouri Pac. R. Co.*, 45 Fed. 818 (1891), Judge Caldwell said: "The owner of all the stock and bonds of a corporation does not own the corporate property. The corporate property, which includes all rights of action and claims for damages, belongs to the corporation, and is subject to the management and control of its board of directors."

In *Humphreys v. McKissock*, 140 U. S. 304 (1891), (11 Sup. Ct. Rep. 779) it was held where a railroad company acquired stock in an elevator company that its interest in such company was that of a stockholder only, and that it had no interest in the property of such company which it could mortgage.

See also *Crane v. Fry*, 126 Fed. 278 (1903); *Jessup v. Illinois Cent. R. Co.*, 36 Fed. 741 (1883).

Where one corporation owns all

the stock of another corporation and elects its directors — the corporate existence being maintained — the former corporation has only the rights and powers of a stockholder in the latter; and is not the corporation itself either in respect of the management of the corporate business or of control of the corporate property.

*Shepp v. Schuylkill Valley Traction Co.*, 17 Montgomery County (Pa.) Law Rep. 52 (1900). The decision in this case is based upon *Pullman Car Co. v. Missouri Pac. R. Co.*, *supra*.

Ownership by one corporation of all the stock of another corporation which maintains its corporate existence does not make the former liable for the negligence of the latter.

*Louisville Gas Co. v. Kaufman*, 105 Ky. 131 (1898), (48 S. W. Rep. 434).

<sup>2</sup> *Pullman Car Co. v. Missouri Pac. R. Co.*, 115 U. S. 597 (1885), (6 Sup. Ct. Rep. 194). In this case, a railroad company made a contract concerning all roads which it did then or might thereafter "control." It afterwards acquired a majority of the stock of another railroad company, and the question was whether it thereby controlled the road of that company within the meaning of the contract. The Court held that it did not.

the control of the road, but that is not, in law, the control itself. Practically it may control the company, but the company alone controls its road. In a sense, the stockholders of a corporation own its property, but they are not the managers of its business or in the immediate control of its affairs.”<sup>1</sup>

§ 296. **Distinction between Control and Community of Interest.** — The phrase, “community of interest,” as used in relation to corporations, especially railroad companies, means the acquisition and holding for a *common purpose*, by several corporations, of stock in other corporations; or the mutual holding by two or more corporations of each other’s shares. The “community of interest idea,” with reference to railroads, is that competing railroad companies, having common stockholders or owning each other’s shares, will maintain rates; that the practical pooling of interests will more than fill the place of the prohibited pooling of traffic or earnings, and prevent traffic wars and ruinous competition.

The element of control is not essential to a community of interest, and the one does not necessarily imply the other. “It may be true that the two companies are acting in harmony, and that the same persons own a majority of the stock of both; but that is something very different from the control of one by the other.”<sup>2</sup>

<sup>1</sup> In *Pennsylvania R. Co. v. Commonwealth* (Pa. 1886), 7 Atl. Rep. 368, a case involving the construction of the Pennsylvania constitutional provision (Art. 17, § 4), against the acquisition by railroad corporations of the control of competing companies, the Court said with reference to the case of *Pullman Car Co. v. Missouri Pac. R. Co.*, *supra*: “The decision of the question of control was not called for in the case, which was already decided on another and a fundamental point. But, waiving this, the point decided is, merely, that the ownership of the stock does not necessarily give control of the road. The Chief Justice says, speaking of the stockholding company: ‘Practically, it may control the company, but the

company alone controls its road.’ . . . This distinction seems very narrow, but it is certainly involved in the conclusion reached, which cannot stand unless it is recognized: for it is too plain to bear argument, that the ownership of the stock of a corporation carries with it the control of the corporation. Indeed, this is merely a different way of stating the truism, that a corporation is controlled by its stockholders. That they do it through the agency of a board of directors and other officers does not alter the fact.”

<sup>2</sup> *Pullman Car Co. v. Missouri Pac. R. Co.*, 11 Fed. 637 (1882), *affirmed* 115 U. S. 587 (1885), (6 Sup. Ct. Rep. 194).

§ 297. **Distinction between Control and Consolidation.** — The distinction between the union of stockholders and properties effected by consolidation and the continued separate existence of the corporations, controlled and controlling, has already been pointed out.<sup>1</sup>

§ 298. **Power to purchase Stock to obtain Control.** — A corporation having power to purchase and hold shares may exercise the power for the purpose of obtaining control of another corporation and of participating in its management.<sup>2</sup> A corpora-

<sup>1</sup> See *ante*, § 12: "*Distinction between Consolidation and Control.*"

<sup>2</sup> *United States: De la Vergne Refrigerating Mach. Co. v. German Savings Inst.*, 175 U. S. 54 (1899), (20 Sup. Ct. Rep. 20); *Louisville, etc. R. Co. v. Kentucky*, 161 U. S. 698 (1896), (16 Sup. Ct. Rep. 714); *Nashua, etc. R. Co. v. Boston, etc. R. Co.*, 136 U. S. 385 (1890), (10 Sup. Ct. Rep. 1004); *Tod v. Kentucky Union Land Co.*, 57 Fed. 58 (1893).

*Illinois: Martin v. Ohio Stove Co.*, 78 Ill. App. 105 (1898).

*New Hampshire: Pearson v. Concord R. Corp.*, 62 N. H. 548 (1883), (13 Am. St. Rep. 590): "A corporation cannot become a stockholder in another corporation unless such power is given to it by its charter, or is necessarily implied in it, especially if the purchase be for the purpose of controlling or affecting the management of the other corporation."

*New Jersey: Elkins v. Camden, etc. R. Co.*, 36 N. J. Eq. 5 (1882).

*Ohio: One railroad company has no power to acquire the bonds of another corporation in order to control the elections of the latter, such bonds having a voting power. State v. McDaniel*, 22 Ohio St. 368 (1872).

In *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721 (1904) it was held, however, that power to purchase stocks for investment does not authorize the purchase of all the stock of a corporation for the purpose of controlling its manage-

ment. In this case the Court said: "The only authority of the Missouri Company to purchase stock in another corporation is found in subdivision 9, § 2839, Rev. St. Mo. 1889, which reads: 'To buy and sell all kinds of government, state, municipal and other bonds, and all kinds of negotiable and non-negotiable paper, stocks and other investment securities.' The context shows very clearly that the purpose was not to authorize the purchase of all of the stock of another company for the purpose of controlling its management but to authorize the buying and selling of stocks as investment securities, in like manner as government bonds and the other securities named are bought and sold. Controlling the management of a corporation of another State through the ownership of its entire stock is not buying or selling investment securities, nor is it fairly incidental thereto. The hazards of such a venture are altogether repugnant to the purposes for which the Missouri Company was formed, which include the handling and investing of the money of others, executing trusts under deeds and wills, acting as guardian of infants and insane persons, and guarantying the fidelity of persons holding places of public and private trust; all requiring the maintenance of a high standard of credit and stability on the part of that company. It is impossible to escape the con-

tion, without such express authority, cannot purchase for control.

In *De la Vergne Refrigerating Mach. Co. v. German Savings Inst.* Mr Justice Brown said:<sup>1</sup> "As the powers of corporations, created by legislative act, are limited to such as the act expressly confers and the enumeration of these implies the exclusion of all others, it follows that, unless express provision is given to do so, it is not within the general powers of a corporation to purchase the stock of other corporations for the purpose of controlling their management."

This statement of the law while correct does not go far enough. It is not only beyond the general powers of a corporation to purchase the stock of other corporations for the purpose of obtaining control, but it is beyond its general powers to make such purchases for any purpose. The only distinction is that while for certain purposes power to acquire stock may exist as incidental to other powers, there can never be an implied power to purchase for control.<sup>2</sup> A purchase for control, without express authority to purchase stock, is necessarily *ultra vires*. A purchase for other purposes, without such authority, is also *ultra vires* unless the requisite power can be implied.

A purchase by a foreign corporation of stock in a domestic corporation for the purpose of obtaining control of, and stifling competition with, it has been held to be *ultra vires* the foreign corporation regardless of the powers expressed in its charter, as well as contrary to public policy.<sup>3</sup>

clusion that the purchase of the Kansas Company's stock was beyond the power of the Missouri Company."

Compare, however, *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673 (1903), (53 Atl. Rep. 842) where it was held that the fact that an insurance company, having power to invest its funds in the shares of other corporations, purchased a controlling interest in the stock of another corporation would not make such purchase illegal provided it were made in good faith for investment purposes.

<sup>1</sup> *De la Vergne Refrigerating Mach.*

*Co. v. German Savings Inst.*, 175 U. S. 54 (1899), (20 Sup. Ct. Rep. 20).

<sup>2</sup> "While this power [to purchase shares] may be incidental to some undisputed authority its exercise can never be sustained as an incidental power when the object is to obtain the control and management of another corporation." Editorial note to *Denny Hotel Co. v. Schram*, 36 Am. St. Rep. 137.

<sup>3</sup> *Dunbar v. American Telephone, etc. Co.*, 224 Ill. 9 (1906), (79 N. E. Rep. 423).



§ 299. **Status of Corporation as Controlling Stockholder.** — There is nothing in the nature of a corporation which forbids it exercising control of another corporation, if power to acquire control is conferred.<sup>1</sup>

When a corporation acquires control of another corporation its rights, in law, are the same as those of any natural person holding control. The two corporations continue to exist as before and each acts through its own directors and officers.<sup>2</sup> They are legally distinct, although acting together for a common purpose and managed in a common interest.

§ 300. **Trust Relation of Controlling Corporation to Minority Stockholders.** — When a majority of the stock of one corporation is owned by another, which thereby acquires the right to control its management, the controlling corporation assumes a relation of trust towards the minority stockholders of the corporation controlled, and is under an obligation to manage its affairs for the benefit of *all* the stockholders and not for its own aggrandisement.<sup>3</sup> This is merely an application of

<sup>1</sup> *Citizens State Bank v. Hawkins*, 71 Fed. 369 (1896); *Matthews v. Murchison*, 17 Fed. 760 (1883); *Market Street R. Co. v. Hellman*, 109 Cal. 571 (1895), (42 Pac. Rep. 225); *White v. Syracuse, etc. R. Co.*, 14 Barb. (N. Y.) 559 (1853).

<sup>2</sup> *Pullman Car Co. v. Missouri Pac. R. Co.*, 11 Fed. 637 (1882), *affirmed* 115 U. S. 597 (1885), (6 Sup. Ct. Rep. 194); *Jessup v. Illinois Cent. R. Co.*, 36 Fed. 735 (1888).

<sup>3</sup> *Farmers Loan, etc. Co. v. New York, etc. R. Co.*, 150 N. Y. 410 (1896), (44 N. E. Rep. 1043, 55 Am. St. Rep. 689, 34 L. R. A. 76); *Barr v. New York, etc. R. Co.*, 96 N. Y. 444 (1884); *George v. Central R., etc. Co.*, 101 Ala. 607 (1893), (14 So. Rep. 752); *Davis v. United States Electric Power, etc. Co.*, 77 Md. 35 (1893), (25 Atl. Rep. 982); *Goodin v. Cincinnati, etc. Canal Co.*, 18 Ohio St. 169 (1868); *Pearson v. Concord R. Corp.*, 62 N. H. 537 (1883), (13 Am. St. Rep. 590).

In *Glengary Consol. Min. Co. v.*

*Boehmer*, 28 Colo. 1 (1900), (62 Pac. Rep. 839) the Court said: "No combination of stockholders of a corporation less than the whole will be permitted to manage or control its affairs in their interest alone. Minority stockholders cannot be deprived of their rights by such a combination under the guise of a policy of the corporation dictated by the majority. So far as the rights of the minority are concerned, the majority, in furtherance of their plan to reap a benefit to themselves through a transaction in which the minority do not participate, become the corporation itself, and assume the trust relation occupied by the corporation towards its stockholders."

For a different view of the obligations of a corporation as a controlling stockholder, see *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673 (1903), (53 Atl. Rep. 848) where the Court said: "Authorities have been cited to support the proposition that an individual or corporation holding a

the principle that, while a majority of the stockholders may legally control the corporation's business, they assume the correlative duty of good faith, and cannot manipulate such business in their own interest to the injury of minority stockholders.<sup>1</sup>

In *Farmers Loan, etc. Co. v. New York, etc. R. Co.*<sup>2</sup> Judge Martin, after considering a number of cases illustrating the general principle, said: "While the question in some of the cases cited arose between stockholders and the directors and

majority of the capital stock of another corporation sustains, by reason of such holding, a fiduciary relation to the minority stockholders and, therefore, it is urged that the acquisition of a majority of Fidelity stock by the Prudential Company should be avoided [citing this section]. But these authorities only hold in effect that the fiduciary relation arises when the majority stockholder assumes control of the corporation and dictates the action of the directors. The majority stockholder is not made a trustee for the minority stockholder in any sense by the mere fact that he holds a majority of the stock, or by the further fact that he uses the voting power of his stock to elect a board of directors for the corporation. The majority stockholder does not necessarily control the directors whom he appoints, and in fact he has no right to control them, and if they are controlled by him they may be violating their duty for which he also may be liable."

See also *Colgate v. United States Leather Co.*, 67 Atl. Rep. 657 (N. J. Ch. 1907). And see *Pierce v. Old Dominion Copper Min., etc. Co.*, 58 Atl. Rep. 319 (N. J. 1904).

<sup>1</sup> *United States v. Ervin v. Oregon R., etc. Co.*, 27 Fed. 630 (1886); *Meeker v. Winthrop Iron Co.*, 17 Fed. 48 (1883). See also *Jackson v. Ludeling*, 21 Wall. 616 (1874). Compare *Rogers v. Nashville, etc. R. Co.*, 91 Fed. 312 (1898).

*California*: *Wright v. Orville Mining Co.*, 40 Cal. 20 (1870).

*Maryland*: In *Cannon v. Brush Electric Co.*, 96 Md. 446 (1903), (54 Atl. Rep. 121) an electric light company owned a controlling interest in another electric light company doing business in the same city in competition with the former company. A stockholder of the latter company brought a bill against the former denying that it was fraudulently using the latter company for its own benefit at the expense of the latter's stockholders. The Court held, and was undoubtedly correct in holding, that none of the acts complained of established bad faith. But the case well illustrates the impossibility of two corporations controlled by the same persons being *real* rivals in business.

*New York*: *Gamble v. Queens County Water Co.*, 123 N. Y. 91 (1890), (25 N. E. Rep. 201); *Sage v. Culver*, 147 N. Y. 241 (1895), (41 N. E. Rep. 513); *Pondir v. New York, etc. R. Co.*, 72 Hun. 384 (1893), (25 N. Y. Supp. 560); *Meyer v. Staten Island R. Co.*, 7 N. Y. St. Rep. 245 (1887).

*England*: *Menier v. Hooper's Telegraph Works*, L. R. 9 Ch. App. 350 (1874); *Gregory v. Patchett*, 33 Beav. 595 (1864).

<sup>2</sup> *Farmers Loan, etc. Co. v. New York, etc. R. Co.*, 150 N. Y. 430 (1896), (44 N. E. Rep. 1043, 55 Am. St. Rep. 689, 34 L. R. A. 76).

officers of a company, who, as such, held a position of trust as to the former, still, where, as in this case, a majority of the stock is owned by a corporation or combination of individuals, and it assumes the control of another company's business and affairs through its control of the officers and directors of the corporation, it would seem that, for all practical purposes, it becomes the corporation of which it holds a majority of the stock, and assumes the same trust relation towards the minority stockholders that a corporation itself usually bears to its stockholders. . . . The principle of these authorities renders it quite obvious that a corporation, purchasing a majority of the stock of a competing one, cannot obtain control of its affairs, divert the income of its business, refuse business which would enable the defaulting company to pay its interest, and then institute an action in equity to enforce its obligations, for the avowed purpose of obtaining entire control of its property to the injury of the minority stockholders. Such a course of action is clearly opposed to the true interests of the corporation itself, plainly discloses that one thus acting was not influenced by any honest desire to secure such interests, but that its action was to serve an outside purpose, regardless of consequences to the debtor company, and in a manner inconsistent with its interest and the interest of its minority stockholders."<sup>1</sup>

The fact that the right to purchase and hold stock is expressly conferred upon a corporation by statute, in no way confers upon it power to employ the stock for inequitable purposes. Without statutory authority, it has no power to hold stocks at all.

<sup>1</sup> The primary injury in *Farmers Loan, etc. Co. v. New York, etc. R. Co.*, *supra*, was to the corporation foreclosed and the injury to stockholders was derivative only. Consequently it was held in a suit brought by an individual stockholder following that decision that the corporation was a necessary party to a suit by a stockholder in behalf of all similarly situated, and that a stockholder could not maintain an individual action for injury to his particular shares.

*Niles v. New York, etc. R. Co.*,

35 Misc. (N. Y.) 69 (1901), (N. Y. Supreme Court).

In *De Neufville v. New York, etc. R. Co.*, 81 Fed. 10 (1897) it was held that a stockholder's bill setting forth facts shown in *Farmers Loan, etc. Co. v. New York, etc. R. Co.*, *supra*, showed an unlawful diversion of the funds of the corporation in question which entitled it to sue for the protection of its rights; and that in default of such action a stockholder could sue in its behalf.

With authority, it assumes the equitable obligations of any majority stockholder.

§ 301. **Remedies of Minority Stockholders of Controlled Corporation.** — While a corporation, holding a controlling interest in another company, so long as it fulfils the obligation of its trust relation towards minority stockholders, may exercise its legal power to determine the policy of the corporation which it controls, it will be restrained by a court of equity, at the instance of a minority stockholder, when it disregards its obligations and manages, or undertakes to manage, the corporation for its own use rather than for the benefit of all the stockholders.<sup>1</sup> The temptation to regulate the affairs of a competing

<sup>1</sup> In *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 462 (1903), (75 Pac. Rep. 89) the Montana Supreme Court said: "Whenever, in the conduct of the business, the purposes of the charter of the Montana Company are ignored and the rights of the minority stockholders are disregarded, the courts of this State have ample power by way of injunction, or a receivership if necessary, to compel it to observe its contract obligations with the State and stockholders."

One railroad company, owning a majority of the stock of another railroad company, and controlling its affairs, has no right to vote its stock so as to manage the corporation for its own use rather than for the latter's benefit, to impair its earnings and prejudice the rights of its minority stockholders; and equity will restrain such voting. *Memphis, etc. R. Co. v. Wood*, 88 Ala. 630 (1889), (7 So. Rep. 108).

Where a railroad company has purchased a majority of the stock of a competing company in order to lessen competition, and, after assuming control, violates its duties in respect to the property and rights of the controlled company, and commits wilful waste, a court of equity will interfere, at the suit of a minority stockholder of the

controlled corporation, and will restrain the controlling corporation from further using its stock in the management of the corporation, and in the election of its officers. *George v. Central R., etc. Co.*, 101 Ala. 607 (1892), (14 So. Rep. 752).

Generally, that one corporation may be enjoined from voting the majority stock held by it in another corporation when the two companies have conflicting interests, see *American, etc. Co. v. Linn*, 93 Ala. 610 (1890), (7 So. Rep. 191); *Mack v. DeBardeleben, etc. Co.*, 90 Ala. 396 (1890), (8 So. Rep. 150).

Where the directors of an insurance company arranged for the transfer of the control of their corporation to a trust company under a scheme which would confer upon them and associates of their choosing great profits and power, it was held that they were disqualified from finally determining that the scheme would be advantageous to their corporation and that the burden was upon them to show that it would be advantageous.

*Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673 (1903), (53 Atl. Rep. 842).

Fraudulent use of its power by a corporation holding a majority of the stock of another corporation, to the

company in its own interest is, naturally, so great that a court of equity will zealously guard the rights of minority stockholders from actual or threatened infringement, and will restrain, by injunction, the controlling corporation from administering the affairs of the corporation in a manner injurious to the corporation and its stockholders as a whole. Equity will compel majority stockholders to exercise their controlling power over a corporation in *its* interest and not for ulterior purposes.

injury of minority stockholders, may constitute ground for the appointment of a receiver for the corporation. *Davis v. United States Electric Power, etc. Co.*, 77 Md. 35 (1893), (25 Atl. Rep. 982).

In *Milbank v. New York, etc. R. Co.*, 64 How. Pr. (N. Y.) 28 (1882), the Court said: "It is against public policy to have, or permit, one corporation to embarrass and control another, and, perhaps, competing corporation, in the management of its affairs, as may be done if it is permitted to own and vote upon the stock." Compare this language with the decision in another New York case (*Oelbermann v. New York, etc. R. Co.*, 77 Hun (N. Y.), 332 (1894), (29 N. Y. Supp. 545)), where it was held that a court of equity could not restrain a controlling corporation from voting on its stock upon allegation or proof that it intended to cause a board of directors to be elected, who, by their action or non-action, might prejudice the interests of minority stockholders.

Where one railroad company controls another, as a part of its system,

through the ownership of stock, and operates the road of the latter company in its own interest, and not in the interest of the controlled company, a receiver, into whose hands both roads have passed, cannot recover from the controlled company expenses incurred in operating it. *Phinizy v. Augusta, etc. R. Co.*, 62 Fed. 771 (1894).

A stockholder has no standing to enjoin the sale of controlling interests in his corporation to another corporation upon the ground that he apprehends that the purchasing corporation will use such control to the prejudice of minority stockholders.

*Ingraham v. National Salt Co.*, 72 App. Div. (N. Y.) 582 (1902), (76 N. Y. Supp. 1116), *affirmed* 179 N. Y. 556 (1904), (71 N. E. Rep. 1128).

That laches may bar a minority stockholder of a corporation, controlled by another, from complaining of the diversion of traffic and misuse of property by the controlling corporation, see *Alexander v. Searcy*, 81 Ga. 536 (1889), (8 S. E. Rep. 630).

## PART V

### COMBINATIONS OF CORPORATIONS

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#### ARTICLE I

#### COMBINATIONS AS AFFECTED BY PRINCIPLES OF CORPORATION LAW

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#### CHAPTER XXVIII

##### NATURE AND FORMATION OF COMBINATIONS

- § 302. Definition of Term "Combination."
- § 303. Definition of Term "Association."
- § 304. Definition of Term "Trust."
- § 305. Popular Use of Word "Trust:"
- § 306. Definition of Phrase "Corporate Combination."
- § 307. Evolution of the Combination.
- § 308. Formation of Associations.
- § 309. Formation of Trusts.
- § 310. Formation of Corporate Combinations.
- § 311. Analysis of Principles determining Legality of Combinations.

§ 302. **Definition of Term "Combination."** — The word "combination" is used in this treatise as a generic term to describe any union of corporations,<sup>1</sup> not amounting to consolida-

<sup>1</sup> Industrial combinations are, practically, combinations of corporations. The modern combination of capital is a corporate combination. Combinations of individuals are, however, governed by the same rules of public policy, and anti-trust legislation — State and federal — is directed both against combinations

of corporations and individuals. The scope of this treatise includes only an examination of the principles relating to combinations of corporations, but, in such examination, it is believed to be both necessary and desirable to refer freely to all illustrative cases — whether of combinations of individuals or of corporations.

tion, entered into by mutual agreement for supposed mutual advantage.<sup>1</sup>

§ 303. **Definition of Term "Association."** — The term "association" is employed to describe that species of combination wherein two or more competing corporations unite, by agreement, for a special purpose of business, and conduct their affairs according to such agreement, but in which there is no community of financial interest and each corporation retains its own property and manages its own affairs.<sup>2</sup>

<sup>1</sup> "The union or association of two or more persons for the attainment of some common end," Century Dictionary *sub nom.* "Combination." In *Watson v. Harlem, etc. Nav. Co.*, 52 How. Pr. (N. Y.) 352 (1877), the Court thus discussed the meaning to be attached to the word "combine" as used in a statute forbidding certain companies to "combine": "The word 'combine' is not to be found in either of the dictionaries of Burrill or Bouvier, and I do not find it defined in the edition of Jacobs to which I have access. Bouvier defines 'combination' as a union of men for the purpose of violating the law, and as a union of different elements. Jacobs, without specifically defining the word, states that 'combinations to do unlawful acts are punishable before the unlawful act is executed; this is to prevent the consequences of combinations and conspiracies,' and he refers to the titles 'Confederacy' and 'Conspiracy.' He defines confederacy to be 'where two or more combine together to do any damage or injury to another, or to do any unlawful act.' As to the meaning of the word 'conspiracy,' he says this word was formerly used almost exclusively 'for an agreement of two or more persons falsely to indict one, or to procure him to be indicted of felony; now it is no less commonly used for the unlawful combination of workmen to raise their wages, or to refuse working except on stipulated conditions.'

Worcester defines 'combine' thus: 'To join together;' 'to coalesce;' 'to unite;' 'to be united;' 'to be joined in friendship or in design.' And he defines 'combination' to be a 'union of persons for certain purposes,' 'association,' 'alliance,' 'coalition,' 'confederacy.' And Roget, in his *Thesaurus*, classifies the word 'combine' as synonymous with or belonging to the same class as 'unite, incorporate, amalgamate, embody, absorb, re embody, blend, merge, fuse, melt into one, consolidate, coalesce, centralize, to impregnate, to put together, to lump together.' . . . I think that there can be no difficulty in determining precisely what the legislature intended in using the word 'combine' in the twenty-seventh section of the act now under consideration. They did not intend to use, and did not use, that word in the strict technical legal sense which is maintained by the counsel for the defendants. The object of the legislature was to prevent coalitions, unions, mutual agreements, blendings of the companies which might be organized and incorporated, under the act, for any purpose."

See also *ante*, § 16: "*Distinction between Consolidation and Combination.*"

<sup>2</sup> "The act of a number of persons who unite or join together for some special purpose or business. The union of a company of persons for the transaction of designated affairs, or the attainment of some common ob-

§ 304. **Definition of Term "Trust."** — A specific definition of the term "trust," as applied to industrial combinations, is: A combination of competing corporations formed through the transfer by the stockholders of several corporations to a common trustee of controlling stock interests therein, in exchange for certificates issued by the trustee for each stockholder's proportional equitable interest in all the stock so transferred.<sup>1</sup>

§ 305. **Popular Use of Word "Trust."** — The word "trust," as popularly used, has a much broader meaning than is indicated by its specific definition. It is applied generally to all combinations of industrial corporations formed for the purpose of regulating the price and supply of commodities.<sup>2</sup> The

ject." Black's Law Dict., *sub nom.* "Association."

"As mercantile concerns under freedom of trade have tended in our cities to be more and more vast and comprehensive and absorb the smaller ones, so it is reasonable to suppose that the right of *association* will be made more and more available in manufacturing. In fact the two tendencies are, in substance, the same. If association is prevented by law different manufactories may be melted into one." Article in "Political Science Quarterly," vol. 3, p. 609, by Prof. Theodore W. Dwight.

<sup>1</sup> "An organization for the control of several corporations under one direction by the device of a transfer by the stockholders in each corporation of at least a majority of the stock to a central committee, or board of trustees, who issue in return to such stockholders, respectively, certificates showing in effect that, although they have parted with their stock and the consequent voting power, they are still entitled to dividends or to share in the profits — the object being to enable the trustees to elect directors in all the corporations, to control and suspend at pleasure the work of any, and thus economize expenses, regulate production

and defeat competition." Century Dict. *sub nom.* "Trust" (specific definition).

A trust "is an arrangement by which the stockholders of various corporations place their stocks in the hands of certain trustees, and take in lieu thereof certificates showing each stockholder's equitable interest in all the stock so held. The result is twofold: 1. The stockholders thereby become interested in all the corporations whose stocks are thus held. 2. The trustees elect the directors of the several corporations." Pamphlet by Mr. S. C. T. Dodd, general solicitor Standard Oil Co., entitled "Combinations: Their Uses and Abuses."

<sup>2</sup> Black's Law Dict. *sub nom.* "Trusts." In *Queen Ins. Co. v. State* (Tex. Civ. App. 1893) 22 S. W. Rep. 1048 (22 L. R. A. 492) the Court said: "The term 'trust' is not employed in a technical legal sense. By very recent commercial usage, the meaning of the word has been extended so as to comprehend combinations of corporations or capitalists for the purpose of controlling the price of articles of prime necessity, or the charges of transportation, to the public."

*Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906),



form of combination is immaterial. Associations for pooling products and corporations formed for the purpose of purchasing corporate properties have both — and with equal inaccuracy — been called “trusts.”

The words “trust” and “combination” are often used synonymously, and a definition of a combination as “a union of men for the purpose of violating the law,”<sup>1</sup> defines a trust as it has sometimes existed, possibly more in the past than in the present, in the popular imagination.

This broad use of the word “trust” to describe combinations which are not in the trust form, producing confusion and sometimes unwarranted prejudice, should be avoided. The word is used in this treatise as applying specifically to the trust form of combination.

§ 306. **Definition of Phrase “Corporate Combination.”** — The phrase “corporate combination” may be defined as a combination of corporations formed by the transfer of the controlling stock interests, or the properties and good-will, of several corporations engaged in the same branch or connected branches

(56 S. E. Rep. 269, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268): “A trust has been defined as a contract, combination, confederation or understanding, express or implied, between two or more persons to control the price of a commodity or services for the benefit of the parties thereto, and to the injury of the public, and which tends to create a monopoly.” See also *State v. Firemen’s Fund Ins. Co.*, 152 Mo. 1 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363).

For definitions of the term “trust” in State anti-trust statutes, see *post*, Ch. XLII.

<sup>1</sup> Bouvier’s Law Dict. (Rawle’s Ed.) *sub nom.* “Combinations.”

The following extract from the opinion in *State v. Armour Packing Co.*, 173 Mo. 356, 387 (1903), (73 S. W. Rep. 645) presents an extreme view of the effect of trusts and combinations: “Competition is the life

of trade.’ Pools, trusts and conspiracies to fix or maintain the prices of the necessities of life, strike at the foundation of government; instil a destructive poison into the life of the body politic; wither the energies of competitors, blight individual investments in legitimate business; drive small and honest dealers out of business for themselves, and make them mere ‘hewers of wood and drawers of water’ for the trust; raise the cost of living and lower the price of wages; take from the average American freeman the ability to supply his family with necessary, adequate and wholesome food; force the boys away from school, and into the various branches of trade and labor, and the girls into workshops and other avenues of business, and make them breadwinners while they are yet almost infants, because the head of the house cannot earn enough to feed and clothe his family.”

of business to a single corporation, formed for the purpose, which by virtue of the transfer acquires a proprietary interest in such stock or properties.<sup>1</sup>

§ 307. **Evolution of the Combination.** — There have been three distinct steps in the development of the present corporate combination, brought about in an attempt to make effective the tendency of modern business life towards the concentration of corporate interests in the face of adverse judicial decisions:

*First.* Associations of corporations for supposed mutual advantage were formed, having for their object, generally, the restriction of production and the regulation of prices. This form of corporate coöperation was usually exemplified by pooling agreements and selling agencies, which left the several corporations independent of each other, except as bound by a more or less informal agreement. Combinations of this character were declared illegal by the courts, as tending to suppress competition and, consequently, as being contrary to public policy.

*Second.* The trust form of combination was resorted to in an attempt to avoid the effect of the decisions against associations, apparently in the belief that the deposit by stockholders of their shares with a common trustee for a common purpose did not constitute a combination of corporations, because

(1) The acts of the stockholders were not the acts of the corporations.

(2) The stockholders of the several corporations had a right, if they saw fit, to deposit their stock with a trustee.

These views, however, were not adopted, in their entirety, by the courts, and the trust form of combination was condemned, not only for the reasons stated in the case of associa-

<sup>1</sup> Strictly speaking, any combination of corporations is a corporate combination. As used in this treatise, however, the phrase has reference rather to the form of the combination than to its elements. The phrase "corporate form of combination" would be more exact but less convenient.

"Combinations," from which the phrase is taken, defines corporate combinations as follows (§ 583): "Combinations formed by the sale or lease of the properties, assets and good-will of the several parties or corporations to one large corporation organized for the purpose of acquiring the several properties."

tions, but because it violated fundamental principles of the law of corporations.

*Third.* The corporate combination was then formed to avoid the effect of the decisions against the "trust." In the form of a corporation *holding* the stocks of the subsidiary companies it has not always withstood attack, even for reasons peculiar to corporation law. In the form of a corporation *purchasing* the plants of the several companies, it seems invulnerable from that standpoint, but, in common with every form of combination, may be successfully attacked if formed for an unlawful purpose.

### § 308. Formation of Associations.

#### (A) *Railroad Pools.*<sup>1</sup>

An agreement between competing railroad or other transportation companies whereby, for the purpose of avoiding

<sup>1</sup> *Pools.* "A railroad pool is an agreement between competing railroads to apportion competing business. More precisely, it is an arrangement made by several railroads competing for business to allot to each a stated percentage of the whole competitive traffic, or of the receipts thereof, together with a mutual guaranty that each road shall receive its share. The purpose of pooling is to remove the incentive to competition. A road will hardly cut its rates to get away another's traffic if there is nothing to be gained by so doing.

"Railroad pools are of two kinds:

- (1) Traffic pools.
- (2) Money pools.

"I. A traffic or tonnage pool is an agreement whereby each member is guaranteed to receive and can receive only a stated percentage of the competitive traffic. Taking a series of years, the percentages of freight carried by competing and well established lines between two important points will not vary greatly. The distribution of business is fairly constant. It is, therefore, easy for the makers of the pool to determine the

proportion of the traffic which each member should receive. A pool to be permanent should be based upon natural percentages. A traffic pool only applies to competitive traffic and sometimes only to through competitive traffic. Local business is unaffected. In fact, rate wars with regard to local competitive traffic have taken place between members of a through traffic pool. When the time for adjusting accounts approaches, if any member has received less than its allotment of the traffic, sufficient freight is diverted from a road which has received in excess of its percentage to make up the deficiency. Freight diverted for this purpose is, if possible, freight not specially routed. But sometimes it is necessary to forward contrary to the preferences of shippers. This makes trouble, and was so great an objection to the traffic pool that it was largely abandoned, even before the enactment of the statute against pooling. . . .

"II. A money pool is an agreement whereby each member is guaranteed to receive and can receive only a stated percentage of the receipts

competition, the joint traffic or earnings are divided between the companies in fixed proportions, constitutes "pooling."

Railroad pools are of two kinds:

(1) *Traffic pools*, wherein an agreed proportion of the traffic or business of all the companies is allotted to each corporation.<sup>1</sup>

(2) *Money pools*, wherein all the earnings or profits are placed in a common fund or pool and divided between the corporations in the proportions stated in the agreement.<sup>2</sup>

Manufacturing corporations may also, if not unlawful, "pool" their products or earnings, but the term is generally used with reference to the agreements of railroad or other transportation companies.<sup>3</sup>

(B) *Industrial Associations:*

Associations of competing industrial corporations have for their primary object the restriction of competition. This object has been sought to be attained under agreements in various forms:

(1) Agreements prescribing a scale of prices at which the products of the several companies shall be sold.<sup>4</sup>

from competitive traffic. This type of pool — called a joint purse — has been common in England. It may be based either upon gross or net earnings. The percentages of the members are, of course, determined by past earnings, but they take their allotments entirely irrespective of actual earnings during the pool's existence. But as one road might incur extra expenses in moving a far greater bulk of traffic than its proportion of the earnings called for, it was customary, during the pooling period of the American railroads, for each road to retain a third or a half of the receipts from the pooled business to cover the actual expenses connected therewith. The remainder of the receipts went into the pool. In some cases the roads were permitted to retain but a very small percentage in order to avoid the temptation to compete for that alone. A moiety

of the earnings might have been attractive to a road in need of funds.

"The money paid into a money pool is periodically distributed by the official in charge according to the stipulated allotments. In this type of pool each road takes all the business offered and conducts its affairs independently of the other members, except as it pools its receipts in whole or part."

From *American Railroad Rates*, by Walter C. Noyes, Boston, 1905, pp. 137-141.

<sup>1</sup> *Eclipse Towboat Co. v. Pontchartrain R. Co.*, 24 La. Ann. 1 (1872).

<sup>2</sup> *Hare v. London, etc. R. Co.*, 2 Johns. & H. 80 (1861), (30 L. J. Ch. 817, 7 Jur. (N. S.), 1145).

<sup>3</sup> For consideration of the legality of "pooling," see *post*, § 364a: *Associations of Railroad Companies*. — (C) *Pools*."

<sup>4</sup> *Dolph v. Troy Laundry Mach.*

(2) Agreements limiting the amount of production of each company.<sup>1</sup>

(3) Agreements appointing a common selling agent to dispose of the products of all the companies at fixed prices, or at prices adjusted by a supervising committee.<sup>2</sup>

(4) Agreements for the purchase of a company's entire production for a term of years.<sup>3</sup>

(5) Agreements to give rebates to members of association.<sup>4</sup>

Many other forms of agreement, modifications of those stated, have also been adopted.

§ 309. **Formation of Trusts.** — The following elements are essential to the formation and existence of the trust form of combination:

(1) The deposit by the holders of a majority of the stock of the several corporations to be combined of their shares with a trustee or trustee body, and the transfer of the legal title thereof to the trustee.

(2) The issue and delivery by the trustee to the stockholders, in lieu of the stock deposited, of trust certificates showing the proportional interest of each stockholder in *all* the stock deposited.

(3) The execution of a trust agreement<sup>5</sup> defining the rights

Co., 28 Fed. (553) (1886); *De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.*, 16 Daly (N. Y.), 529 (1891), (14 N. Y. Supp. 277); *Cohen v. Berlin & Jones Env. Co.*, 38 App. Div. (N. Y.) 499 (1899), (56 N. Y. Supp. 588); *Nester v. Continental Brewing Co.*, 161 Pa. St. 473 (1894), (29 Atl. Rep. 102); *Herriman v. Menzies*, 115 Cal. 16 (1896), (44 Pac. Rep. 660, 56 Am. St. Rep. 82, 35 L. R. A. 318); *Texas Standard Oil Co. v. Adoue*, 83 Tex. 650 (1892), (19 S. W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598).

<sup>1</sup> *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173 (1871), (8 Am. Rep. 159); *Santa Clara Valley Mill, etc. Co. v. Hayes*, 76 Cal. 387 (1888), (18 Pac. Rep. 391, 9 Am. St. Rep. 211).

<sup>2</sup> *Morris Run Coal Co. v. Barclay.*

*Coal Co.*, 68 Pa. St. 173 (1871), (8 Am. Rep. 159); *Skrainka v. Scharinghausen*, 8 Mo. App. 522 (1880); *Central Shade Roller Co. v. Cushman*, 143 Mass. 353 (1887), (9 N. E. Rep. 629); *Cummings v. Union Blue Stone Ass'n*, 15 App. Div. (N. Y.) 602 (1897), (44 N. Y. Supp. 787). See also *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906), (56 S. E. Rep. 273, 116 Am. St. Rep. 901, 10 L. R. A. (n. s.) 268).

<sup>3</sup> *Live Stock Ass'n v. Levy*, 54 N. Y. Super. Ct. 32 (1886); *Pacific Factor Co. v. Adler*, 90 Cal. 110 (1891), (27 Pac. Rep. 36, 25 Am. St. Rep. 102).

<sup>4</sup> *Mogul Steamship Co. v. McGregor*, L. R. 17 App. Cas. 25 (1891), (61 L. J. R. 295).

<sup>5</sup> The trust agreement in the case of

of the parties; providing, usually, for the election and succession of trustees, their term of office and the transfer of trust certificates, and *necessarily* providing

(A) That the trustee shall vote the stock deposited and elect the directors of the several corporations.

(B) That the trustee shall receive all dividends from the several corporations and place them in a common fund.

(C) That the trustee shall make dividends from this fund — when sufficient for the purpose — upon the trust certificates.

§ 310. **Formation of Corporate Combinations.** — As indicated by the definition, corporate combinations generally take one of two distinct forms, and are usually created in the manner following:

(1) In pursuance of an agreement between persons interested in competing corporations, a *holding* corporation is organized, under the laws of a State permitting its corporations to acquire and hold the stock of other corporations, with a capital stock at least equal to the aggregate capital of the several corporations. This corporation issues its own shares, upon an agreed basis, in exchange for the shares of the several corporations, being certain to obtain at least a majority of the shares of each corporation. All the corporations continue in existence, and the subsidiary companies are controlled by the holding corporation, which derives its income from the dividends paid by them. In organizing this form of corporate combination the dealings are entirely between the holding corporation and the *stockholders* of the several companies.<sup>1</sup>

(2) As a part of a plan for combining competing corporate interests, a *purchasing* corporation is organized, with a share capital sufficiently large for the purpose, which purchases

the Sugar Trust is stated at length in *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33), and that in the case of the Standard Oil Trust, in *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 36 Am. & Eng. Corp. Cas. 1, 15 L. R. A. 145).

<sup>1</sup> *Robinson v. Holbrook*, 148 Fed. 109 (1906): "Ordinarily, corporate combinations effected through a holding corporation are organized by dealings which are entirely between the holding corporation and the shareholders of the several companies whose shares are to be held." Citing this section.

the properties — plants, stock in trade and good-will — of the several corporations and issues its own stock in payment therefor. Preferred stock is generally issued for tangible assets; common stock, for good-will. The shares are usually delivered to the vendor corporations, but may be directly distributed among their stockholders.

The purchasing corporation, as the result of this process, becomes the absolute owner of the property of all the corporations, and may continue or suspend the business theretofore carried on by them, and otherwise manage its affairs, without restriction or supervision except by the State and its own stockholders. This form of corporate combination is, in its creation, wholly between the two corporations, vendor and purchaser, and is least liable of all to violate any principle of corporation law.

In particular instances, this form has been modified and corporate properties have been taken over under lease instead of sale. So, corporate combinations have been brought about by uniting the two methods — by acquiring both the stock and the property of the several corporations, or the stock of some and the property of others.

§ 311. **Analysis of Principles determining Legality of Combinations.** — The legality of a combination of corporations in any form — trust, corporate combination or simple association — must be ascertained by the application of the following negative principles:

(1) *A combination of corporations is illegal which contravenes the principles of law governing corporations.*

In applying this principle it is of importance to ascertain:

(A) The manner of organization.

(B) The powers of the companies.

(2) *A combination is illegal which contravenes rules of public policy.*<sup>1</sup>

In applying this principle it is of essential importance to ascertain:

(A) The purposes of the combination — as a fact.

(B) The rules of public policy — as a matter of law.

<sup>1</sup> A combination amounting to a combinations of capital are seldom conspiracy is also illegal, but modern conspiracies. See *post*, § 328.

(C) The bearing of the rules upon the facts.

(3) *A combination is illegal which contravenes any statutory provision.*

The application of this axiomatic principle, in any particular case, may depend upon:

(A) The form and object of the combination.

(B) The constitutionality and construction of the statute.

## CHAPTER XXIX

### PRINCIPLES OF CORPORATION LAW AFFECTING ASSOCIATIONS AND TRUSTS

§ 312. Legality of Associations not generally a Question of Corporation Law.

§ 313. In Formation of Trust, State regards Acts of Stockholders as Acts of Corporation.

§ 314. Trust invalid as involving Partnership of Corporations.

§ 315. Trust invalid as involving Delegation of Corporate Powers.

§ 316. Trust invalid as involving Practical Consolidation.

§ 317. Rights and Liabilities growing out of Trusts.

§ 312. **Legality of Associations not generally a Question of Corporation Law.** — The association of several corporations for the promotion of their common interests is merely the exercise of the general right to contract, pertaining to every corporation within the limitations of its charter.

Corporations, retaining the management of their affairs, may generally — so far as principles of corporation law are concerned — enter into such agreements with other corporations as they may deem expedient. Such agreements are seldom *ultra vires*, except in the broad sense that an unlawful act is always *ultra vires*. The test of illegality, however, lies in the application of other principles than those of corporation law.

§ 313. **In Formation of Trust, State regards Acts of Stockholders as Acts of Corporation.** — One reason for adopting the trust form of combination was the assumption that because the corporations were not parties to the agreement between



the stockholders and the trustee, they did not, themselves, participate in the combination.

This assumption was based upon the legal fiction that a corporation is a legal entity separate and distinct from the natural persons who compose it. This fiction is necessary for the protection and enforcement of rights between the corporation, its stockholders and persons with whom it has dealings, but it has no place in the relations of a corporation with the State which created it. The State grants the charter of incorporation to the incorporators and may take that charter away from them. It deals with a corporation as a collection of its members, and treats their united acts as the acts of the corporation, because, from its point of view, they *are* the corporation. A trust, formed by the stockholders of corporations, in the eyes of the State is the creation of the corporations.

In the *Sugar Trust Case*,<sup>1</sup> the Court of Appeals of New York said: "The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought,\* is itself a fiction, and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as permitted by the law; and the substantial inquiry always is what, in a given case, has been that collective action and agency. As between the corporation and those with whom it deals, the manner of its exercise usually is material, but as between it and the State, the substantial inquiry is only what that collective action and agency has done, what it has, in fact, accomplished, what is seen to be its effective work, what has been its conduct. It ought not to be otherwise. The State gave the franchise, the charter, not to the impalpable, intangible and almost nebulous fiction of our thought, but to the incorporators, the individuals, the acting and living men, to be used by them, to redound to their benefit, to strengthen their hands and add energy to their capital. If it is taken away, it is taken from them as individuals and incorporators, and the legal fiction disappears. The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct;

<sup>1</sup> *People v. North River Sugar* (24 N. E. Rep. 834, 18 Am. St. Rep. Ref'g Co., 121 N. Y. 621 (1890), 483, 9 L. R. A. 33).

and when they all act, collectively, as an aggregate body, without the least exception, and so acting, reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility, of the corporation itself, we cannot hesitate to conclude that there has been corporate conduct which the State may review, and not be defeated by the assumed innocence of a convenient fiction.”<sup>1</sup>

**§ 314. Trust invalid as involving Partnership of Corporations.** — The primary object in forming a trust is to concentrate the control of several competing corporations into a single board. The several corporations, through the instrumentality

<sup>1</sup> In the case of *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145, 36 Am. & Eng. Corp. Cas. 1), similar conclusions were reached by the Supreme Court of Ohio. Judge Minshall said (p. 177): “The general proposition that a corporation is to be regarded as a legal entity, existing separate and apart from the natural persons composing it, is not disputed; but that the statement is a mere fiction, existing only in idea, is well understood, and not controverted by any one who pretends to accurate knowledge on the subject. It has been introduced for the convenience of the company in making contracts, in acquiring property for corporate purposes, in suing and being sued, and to preserve the limited liability of the stockholders, by distinguishing between the corporate debts and property of the company, and of the stockholders in their capacity as individuals. All fictions of law have been introduced for the purpose of convenience and to subserve the ends of justice. It is in this sense that the maxim, *In fitione juris subsistit æquitas*, is used, and the doctrine of fictions applied. But when they are urged to an intent and purpose not within the reason and policy of the fiction they have always

been disregarded by the courts. . . . (p. 179) Now so long as a proper use is made of the fiction that a corporation is an entity apart from its shareholders, it is harmless, and because convenient, should not be called in question; but when it is urged to an end subversive of its policy, or such is the issue, the fiction must be ignored, and the question determined, whether the act in question, though done by shareholders, that is to say, by the persons united in one body, was done simply as individuals and with respect to their individual interests as shareholders, or was done ostensibly as such, but, as a matter of fact, to control the corporation and affect the transaction of its business, in the same manner as if the act had been clothed with all the formalities of a corporate act. This must be so, because the stockholders, having a dual capacity, and capable of acting in either, and a possible interest to conceal their character when acting in their corporate capacity, the absence of the formal evidence of the character of the act cannot preclude judicial inquiry on the subject. If it were otherwise, then, in one department of the law, fraud would enjoy an immunity awarded to it in no other.”

of the trustees, are managed for a common purpose, and their stockholders divide the profits of a joint enterprise. The whole arrangement constitutes a partnership of corporations.<sup>1</sup> As said by the Supreme Court of Tennessee in the *Cotton Seed Oil Trust Case*:<sup>2</sup> "A careful examination of this agreement discloses every material element of the contract of partnership. The absolute ownership of the corporate property, the mills, machinery, etc., is not conveyed to the partnership, nor is this necessary. The beneficial use of all such property is surrendered to the common purpose. The provisions for the complete possession, control and use of the properties of the several corporations by the partnership or syndicate is perfect. Nothing is left to the several corporations but the right to receive a share of the profits and participate in the management and control of the consolidated interests as members of the new association. The contract is, both technically and in its essential character, a partnership in so far as it is possible for corporations to form such an association."

A trust, therefore, constituting a partnership of corporations, must depend for its validity upon the power of the corporations to form a partnership. No such implied power exists. A partnership is inconsistent with the scope, object, powers and obligations of a corporation. It interferes with the management of the affairs of a corporation by its own officers, impairs the authority of the stockholders, involves

<sup>1</sup> Trusts have been held to amount to partnerships of corporations in the following leading cases: *Mallory v. Hanaur Oil Works*, 86 Tenn. 598 (1888), (8 S. W. Rep. 396, 20 Am. & Eng. Corp. Cas. 478); *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33); *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145, 36 Am. & Eng. Corp. Cas. 1); *American Preservers Trust v. Taylor Mfg. Co.*, 46 Fed. 152 (1891); *Bishop v. American Preservers Co.*, 157 Ill. 284 (1895), (41 N. E. Rep. 765, 48 Am.

St. Rep. 317). In the last case the Court said: "It will thus be seen that the agreement in question makes provision for welding together all the interests engaged in the business named in the agreement into one giant combination or partnership, under the absolute dominion and control of a board of nine trustees. . . . The agreement was illegal as providing for a partnership among corporations. It is a violation of the law for corporations to enter into partnership."

<sup>2</sup> *Mallory v. Hanaur Oil Works*, 86 Tenn. 602 (1888), (8 S. W. Rep. 396, 20 Am. & Eng. Corp. Cas. 478).

the corporation in outside enterprises, and is opposed to public policy.<sup>1</sup>

In the absence of express legislative authority to enter a partnership, it is *ultra vires* of a corporation to enter a trust.<sup>2</sup>

§ 315. **Trust invalid as involving Delegation of Corporate Powers.** — Statutes relating to the organization and management of corporations contain provisions for their control, primarily, by their stockholders, and, immediately, by their directors, and indicate the policy of the State that the affairs of corporations should be conducted, really as well as formally, by their own officials. The formation of a trust substitutes the trustees as the governing body and makes the directors merely tools.<sup>3</sup> It involves the delegation of corporate powers,

<sup>1</sup> *United States: American Preservers Trust v. Taylor Mfg. Co.*, 46 Fed. 152 (1891).

*Alabama: Central R., etc. Co. v. Smith*, 76 Ala. 572 (1884), (52 Am. Rep. 353).

*Georgia: Gunn v. Central R., etc. Co.*, 74 Ga. 509 (1885).

*Illinois: Bishop v. American Preservers Trust*, 157 Ill. 284 (1895), (41 N. E. Rep. 765, 48 Am. St. Rep. 317); *Marine Bank v. Ogden*, 29 Ill. 248 (1862).

*Massachusetts: Whittendon Mills v. Upton*, 10 Gray, 582 (1858), (71 Am. Dec. 681).

*New York: People v. North River Sugar Ref'g Co.*, 121 N. Y. 623 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33): "It is a violation of the law for corporations to enter into a partnership. The vital characteristics of the corporation are of necessity drowned in the paramount authority of the partnership."

See also *New York, etc. Canal Co. v. Fulton Bank*, 7 Wend. 412 (1831).

*Ohio: State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145, 36 Am. & Eng. Corp. Cas. 1).

*Tennessee: Mallory v. Hanaur Oil Works*, 86 Tenn. 598 (1888), (8 S. W.

Rep. 396, 20 Am. & Eng. Corp. Cas. 478).

<sup>2</sup> *Southern Electric Securities Co. v. State* (Miss. 1907), 44 So. Rep. 786: "A combination of two or more corporations for a legitimate purpose, and which is unobjectionable as a combination, may be subject to attack if a trust form is adopted, on the ground that each constituent corporation has violated some provision of its charter or some principle of the laws of its creation."

<sup>3</sup> In *Gould v. Head* ("American Cattle Trust" Case), 38 Fed. 888 (1889), (reversed on appeal, 41 Fed. 240 (1890)), Judge Hallett said: "The corporations thus associated renounced autonomy, but not their existence. They committed their affairs into the hands of the trust, because they could be better managed by the trust than by themselves. They still lived and owned their property, but the trust was a regency of their own creation, with absolute and irrevocable power over all their concerns. Ten corporations are mentioned in the affidavits as thus united in the trust, not by the direct act of the corporations, but by transfer of their stock to the trust, or to persons holding in its interest. And it is

is against public policy, and is inconsistent with the purposes for which corporations are created.

In the *Case of the Standard Oil Trust*,<sup>1</sup> the Supreme Court of Ohio said: "The law requires that a corporation should be controlled and managed by its directors in the interests of its own stockholders, and conformable to the purpose for which it was created by the laws of its State."

This principle underlies the objection that trusts amount to corporate partnerships, but is applicable, with equal force, if any element necessary to constitute a partnership be lacking.<sup>2</sup>

§ 316. **Trust invalid as involving Practical Consolidation.** — A combination of corporations by means of a trust amounts to a practical consolidation. The actual results of a union of corporate interests are obtained without subjection to the restraints imposed by the State when authorizing corporations to consolidate. Under consolidation statutes, the result may be a new corporation, owing obligations to the State and with limitations imposed upon the amount of its stock. The result of the formation of a trust is an irresponsible board of trustees, and a virtual doubling of paper capital by the issue of trust certificates for shares.

Consolidation, without statutory authority, is opposed to public policy. Substantial consolidation is equally against

urged that by some general expression in the articles of association the trust was given absolute authority to sell and dispose of the stock in its discretion. But this interpretation is not in accord with the purpose for which the trust was organized. The stock was transferred to the trust not for the purpose of being sold, but to give control of the corporation; to make the officers puppets in the hands of the trust, and thus substitute the latter as the governing body of the corporation."

See also *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33).

<sup>1</sup> *State v. Standard Oil Co.* 49 Ohio St. 185 (1892), (30 N. E. Rep.

279, 34 Am. St. Rep. 541, 36 Am. & Eng. Corp. Cas. 1, 15 L. R. A. 145).

<sup>2</sup> *State v. Standard Oil Co.*, 49 Ohio St. 185 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 36 Am. & Eng. Corp. Cas. 1, 15 L. R. A. 145): "That the nature of the agreement is such as to preclude the defendant from becoming a party to it, is, we think, too clear to require much consideration by us. In the first place whether the agreement should be regarded as amounting to a partnership between the several companies, limited partnerships and individuals, who are parties to it, it is clear that its observance must subject the defendant to a control inconsistent with its character as a corporation."

public policy, for it involves a failure in the performance of corporate duties. Judge Finch, in the *Sugar Trust Case*,<sup>1</sup> stated, in very vigorous language, his opinion of the tendencies of trusts and similar combinations and their effect upon the public interests: "As corporate grants are always assumed to have been made for the public benefit, any conduct which destroys their normal functions, and maims and cripples their separate activity, and takes away their free and independent action, must so far disappoint the purpose of their creation as to affect unfavorably the public interest; and that to a much greater extent when, beyond their own several aggregations of capital, they compact them all into one combination, which stands outside of the ward of the State, which dominates the range of an entire industry, and puts upon the market a capital stock proudly defiant of actual values, and capable of an unlimited expansion. It is not a sufficient answer to say that similar results may be lawfully accomplished; that an individual having the necessary wealth might have bought all these refineries, manned them with his own chosen agents, and managed them as a group at his sovereign will; for it is one thing for the State to respect the rights of ownership and protect them out of regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations. The individuals are few who hold in possession such enormous wealth, and fewer still who peril it all in a manufacturing enterprise; but if corporations can combine, and mass their forces in a solid trust or partnership, with little added risk to the capital already embarked, without limit to the magnitude of the aggregation, a tempting and easy road is opened to enormous combinations, vastly exceeding in number and in strength, and in their power over industry, any possibilities of individual ownership;<sup>2</sup> and the

<sup>1</sup> *People v. North River Sugar Ref'g Co.*, 121 N. Y. 625 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33).

<sup>2</sup> This language seems prophetic, viewed in the light of the present day of billion-dollar combinations. The

reasoning, however, is inconclusive. The State may properly limit the capital of corporations and may restrain their combination. But, in the absence of such limitation or restraint, the tendency of combinations to produce "enormous" "aggre-

State, by the creation of the artificial persons constituting the elements of the combination, and failing to limit and restrain their powers, becomes itself the responsible creator, the voluntary cause of an aggregation of capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing, what it should cause and create is quite another."

§ 317. **Rights and Liabilities growing out of Trusts.** — While the rights and liabilities of trustees and certificate holders, and the nature of trust certificates and privileges attaching thereto, have received judicial consideration,<sup>1</sup> — especially in the embryonic stage of the trust, — it must be borne in mind, in examining the decisions, that trusts have now been generally declared invalid, and that the courts may decline to lend their aid to any of the parties to an illegal enterprise.<sup>2</sup>

The holders of trust certificates are the equitable owners of shares deposited.<sup>3</sup> The certificates represent property, and it has been held that although the trust is illegal the rights of certificate holders will be respected by the courts;<sup>4</sup> that they

gations" of capital in no way indicates their illegality. The words are merely relative, and no principle of the common law limits the amount of property to be held by a person or private corporation.

<sup>1</sup> I. *Rights of trustees.*

The trustees hold the stock in the several corporations as trustees and not as vendees. *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33). Their right to sell the shares so held depends upon the terms of the trust agreement. Trustees authorized by the agreement "to acquire, receive, hold and dispose of" such shares have power to sell them to third persons. *Gould v. Head*, 41 Fed. 240 (1890), reversing 38 Fed. 886 (1889). Compare *People v. North River Sugar Ref'g Co.*, 54 Hun (N. Y.), 354 (1889), (3 N. Y. Supp. 401).

II. *Transferability of certificates.*

Trust certificates are transferable like shares of stock. *Cameron v.*

*Havemeyer*, 25 Abb. N. C. 438 (1890), (12 N. Y. Supp. 126). See also *Gould v. Head*, 41 Fed. 240 (1890). Where trust certificates are made transferable upon the books of the trust, a trustee can be compelled to make the transfer and to issue a new certificate to the transferee. *Rice v. Rockefeller*, 134 N. Y. 174 (1892), (31 N. E. Rep. 907, 30 Am. St. Rep. 658, 17 L. R. A. 237). See also as to the nature of trust certificates, *State v. American Cotton Oil Trust*, 40 La. Ann. 8 (1888), (3 So. Rep. 409).

<sup>2</sup> *Bishop v. American Preservers Co.*, 157 Ill. 284 (1895), (48 Am. St. Rep. 317, 41 N. E. Rep. 765); *American Biscuit, etc. Co. v. Klotz*, 44 Fed. 721 (1891).

<sup>3</sup> *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 483, 9 L. R. A. 33).

<sup>4</sup> *State v. American Cotton Oil Trust*, 40 La. Ann. 8 (1888), (3 So. Rep. 409): "If, as alleged, these cer-

are entitled to have the property and business of the trust placed in the hands of a receiver for the purpose of winding up its affairs.<sup>1</sup>

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## CHAPTER XXX

### PRINCIPLES OF CORPORATION LAW AFFECTING CORPORATE COMBINATIONS

§ 318. Corporate Combinations by Means of Purchasing Corporations — In General.

§ 319. Issue of Stock for Property in Formation of Corporate Combination.

§ 320. Issue of Stock for Good-will in Formation of Corporate Combination.

§ 321. Over-valuation of Property acquired by Issue of Stock.

§ 322. Power of Vendor Corporations to sell Properties for Stock of Purchasing Corporation.

§ 323. Corporate Combinations through Formation of Holding Corporations.

**§ 318. Corporate Combinations by Means of Purchasing Corporations — In General.** — Any purchase by one corporation of the plants and properties of other companies involves, in a sense, a combination of interests. The separate properties are united, and the business theretofore carried on by the different corporations is conducted by one.

The result may be the same whether the several plants are purchased from time to time as incidental to the development and extension of the business of the purchasing corporation, or whether they are taken over at one time by a corporation formed for that express purpose. The phrase "corporate combination" is, however, only applicable in the latter case. The methods adopted in forming corporate combinations of this character vary in detail, but usually follow the forms outlined in a preceding section.<sup>2</sup>

tificates have been taken as the price or in exchange for ten million dollars of property transferred to the trust, then, whatever be their validity and effect as shares of stock, whether or not they confer on the holders the privileges of corporate stockholders, or whether or not they confer the right to participate in the carrying

on of any illegal business, yet they undoubtedly do represent an interest in the property referred to, and, as such, have a legal and real value."

<sup>1</sup> *Cameron v. Havemeyer*, 25 Abb. N. C. (N. Y.) 438 (1890), (12 N. Y. Supp. 126).

<sup>2</sup> See *ante*, § 310: "Formation of Corporate Combinations."



The principles of corporation law, applicable in the formation of corporate combinations, relate, generally, to the power of the purchasing corporation to issue stock for property, including good-will, and the method of valuing such property; and to the power of the selling corporations to exchange their property for stock in another corporation.

§ 319. **Issue of Stock for Property in Formation of Corporate Combination.** — In the formation of a corporate combination, payment for the plants and properties taken over is nearly always made in the stock of the purchasing corporation.

The available cash is often required for a working capital and, moreover, the payment of cash for plants would eliminate the vendor corporations from the transaction. A corporate combination, while in the form of a purchase and sale of properties, in reality is a union of interests, and the issue of stock of the purchasing corporation, directly or indirectly, to the stockholders of the several companies, accomplishes the double purpose of paying for the plants acquired and of retaining the interests of the old stockholders in the new corporation.

The transfer of property for an original issue of stock is, strictly speaking, a payment of an informal subscription, the term "sale" applying more exactly to the transfer of stock already issued. The terms "purchase" and "sale" are, however, in common usage, applied to the acquisition by one corporation of the properties of others in exchange for its stock.

The right to issue stock for any property which a corporation has power to acquire is clearly established.<sup>1</sup> Questions

<sup>1</sup> The following cases are merely illustrative of the current of authority:

*United States*: Washburn v. National Wall Paper Co., 81 Fed. 17 (1897); Northwestern Mutual Life Ins. Co. v. Exchange Real Est. Co., 70 Fed. 155 (1895); Foreman v. Bigelow, 4 Cliff. 508 (1878). See also Loud v. Pomona, etc. Co., 153 U. S. 564 (1894), (14 Sup. Ct. Rep. 928); Coit v. Gold Amalgamating Co., 119 U. S. 343 (1886), (7 Sup. Ct. Rep. 231); Branch v. Jesup, 106 U. S. 468 (1882), (1 Sup. Ct. Rep. 495);

Coe v. East & West R. Co., 52 Fed. 531 (1892).

*Alabama*: Frenkel v. Hudson, 82 Ala. 158 (1887), (2 So. Rep. 758, 60 Am. Rep. 736).

*Georgia*: Hayden v. Atlanta Cotton Factory, 61 Ga. 233 (1878).

*Illinois*: Farwell v. Great West. Tel. Co., 161 Ill. 522 (1896), (44 N. E. Rep. 891); Reichwald v. Commercial Hotel Co., 106 Ill. 439 (1883).

*Indiana*: Coffin v. Ransdell, 110 Ind. 417 (1887), (11 N. E. Rep. 20); Bruner v. Brown, 139 Ind. 600 (1894), (38 N. E. Rep. 318).

may arise as to the valuation of property taken, but the power of a corporation to agree with a subscriber to receive property in payment for stock cannot be questioned at the present day. Only where the governing statute expressly requires payment in money is money's worth insufficient.<sup>1</sup>

In form, the transaction is direct. The property is transferred to the corporation, and the stock is issued in exchange therefor. The formality of paying a subscription in money and immediately paying back the money for property is entirely unnecessary.<sup>2</sup>

Statutes have been passed in many States authorizing corporations, under prescribed conditions, to purchase property by the issue of stock, and to accept property in payment

*Kansas*: Walburn v. Chenault, 43 Kan. 352 (1890), (23 Pac. Rep. 657).

*Kentucky*: Phillips v. Covington, etc. Bridge Co., 2 Metc. 219 (1859).

*Louisiana*: Edwards v. Bringier Sugar Ext. Co., 27 La. Ann. 118 (1875).

*Maryland*: Brant v. Ehlen, 59 Md. 1 (1882).

*Massachusetts*: New Haven, etc. Co. v. Linden Spring Co., 142 Mass. 349 (1886), (7 N. E. Rep. 773); Wyman v. American Powder Co., 8 Cush. 168 (1851).

*Michigan*: Young v. Erie Iron Co., 65 Mich. 111 (1887), (31 N. W. Rep. 814).

*Minnesota*: Hastings Malting Co. v. Iron Range Brewing Co., 65 Minn. 28 (1896), (67 N. W. Rep. 652).

*Missouri*: Woolfolk v. January, 131 Mo. 620 (1895); Chouteau v. Dean, 7 Mo. App. 210 (1879).

*Nebraska*: Troup v. Horback, 53 Neb. 795 (1898), (74 N. W. Rep. 326).

*New Jersey*: Weatherby v. Baker, 35 N. J. Eq. 501 (1882). See New Jersey statute in a following note.

*New York*: Van Cott v. Van Brunt, 82 N. Y. 535 (1880); Barr v. New York, etc. R. Co., 125 N. Y. 263 (1891), (26 N. E. Rep. 145); Gamble

v. Queens County Water Co., 123 N. Y. 91 (1890), (25 N. E. Rep. 201).

*North Carolina*: Clayton v. Ore Knob Co., 109 N. C. 385 (1891), (14 S. E. Rep. 36, 9 L. R. A. 669).

*Ohio*: Goodin v. Evans, 18 Ohio St. 150 (1868).

*Pennsylvania*: Shannon v. Stevenson, 173 Pa. St. 419 (1896), (34 Atl. Rep. 218); Johnston v. Markle Paper Co., 153 Pa. St. 189 (1893), (25 Atl. Rep. 560).

*Tennessee*: Shield v. Clifton Hill Land Co., 94 Tenn. 123 (1894), (28 S. W. Rep. 668, 45 Am. St. Rep. 700, 26 L. R. A. 509); Searight v. Payne, 6 Lea, 283 (1880).

*Washington*: Kroenert v. Johnston, 19 Wash. 96 (1898), (52 Pac. Rep. 605).

*England*: *Re Wragg*, 1 Ch. Div. 796 (1897), *Spargo's Case*, L. R. 8 Ch. App. 407 (1873); *Larocque v. Beauchemin*, App. Cas. 358 (1897); *Burkinshaw v. Nichols*, L. R. 3 App. Cas. 1004 (1878).

<sup>1</sup> In *Connecticut*, until 1901, the statute required that twenty per cent of the subscriptions to all joint stock companies should be paid in in cash.

<sup>2</sup> *Chouteau v. Dean*, 7 Mo. App. 214 (1879): "It is not now questioned that a corporation may issue its stock

of subscriptions.<sup>1</sup> The conditions of such statutes are limitations upon the powers of the corporations.

§ 320. **Issue of Stock for Good-will in Formation of Corporate Combination.** — In combining the interests of different business establishments into a single corporation, it is essential that they should be taken over as going concerns. The purchasing corporation is organized for the purpose of acquiring, not only the plants and tangible assets of the several companies, but also their business, and issues its stock—usually the common shares—for the purchase of their good-will.

The good-will of a business is property for which stock may lawfully be issued, either at common law or under statutes authorizing the issue of stock “for property actually received”<sup>2</sup> by the corporation<sup>3</sup> It has a value independent

by way of payment in the purchase of property. This is on the principle that there is no need for the round-about process of first issuing the stock for money and then paying the money for the property.” See also *Liebke v. Knapp*, 79 Mo. 22 (1883), (49 Am. Rep. 212); *Spargo's Case*, L. R. 8 Ch. App. 407 (1873).

<sup>1</sup> *New Jersey*. Corporation Act of 1896, § 49, p. 293: “Any corporation formed under this act may purchase mines, manufactories or other property necessary for its business, or the stock or any company or companies owning, mining, manufacturing or producing materials, or other property necessary for its business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be full-paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payment under any of the provisions of this act; and, in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive.”

The provision of the English Companies Act of 1867, 30 and 31 Vict.

ch. 131, § 25, is as follows: “Every share in any company shall be deemed and taken to have been issued and to be subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by a contract duly made in writing, and filed with the registrar of joint stock companies at or before the issue of such shares.”

<sup>2</sup> *New York* Stock Corporation Law 1892, ch. 688, § 4, as amended by Laws 1901, ch. 354 (*Birdseye's R. S.* 1901, p. 3418, § 42).

<sup>3</sup> *Washburn v. National Wall Paper Co.*, 81 Fed. 17 (1897). See also *Beebe v. Hatfield*, 67 Mo. App. 609 (1897); *Pell's Case*, L. R. 5 Ch. App. 11 (1869). But compare *Camden v. Stuart*, 144 U. S. 115 (1892), (12 Sup. Ct. Rep. 585), where the Supreme Court of the United States said: “The experience and good-will of the partners, which it is claimed were transferred to the corporation, are of too unsubstantial and shadowy a nature to be capable of pecuniary estimation in this connection. It is not denied that the experience and good-will of a business may be the subject of barter and sale as between the parties to it, but in a case of

of the tangible assets of the vendor corporation, may be conveyed separately from them and for a different class of stock, and its value may be fixed by appraisal. The question whether a particular method of appraisal is proper cannot be raised by a party to a combination who has approved of, and participated in, the application of such method in the sale of the good-will of his own business.

In *Washburn v. National Wall Paper Co.*<sup>1</sup> Judge Lacombe said: "The first of these propositions suggests the questions whether stock is issued for 'property actually received,' within the meaning of the statute, when it is issued for good-will only; and whether . . . the good-will taken in this case was taken at its actual value. . . . Good-will has been defined as 'all that good disposition which customers entertain towards the house or business identified by the particular name or firm, and which may induce them to continue giving their custom to it.' There is nothing marvellous or mysterious about it. When an individual or a firm or a corporation has gone on for an unbroken series of years conducting a particular business, and has been so scrupulous in fulfilling every obligation, so careful in maintaining the standard of the goods dealt in, so absolutely honest and fair in all business dealings that customers of the concern have become convinced that their experience in the future will be as satisfactory as it has been in the past, while such customers' good report of their own experience tends continually to bring new customers to the same concern, there has been produced an element of value quite as important — in some cases, perhaps, far more important — than the plant or machinery with which the business is carried on. . . . Since good-will is property, and since, in some cases, it is valuable property, it would follow that, in some way or other, it must be practically possible to determine what that value is. Whether the particular method employed in the case at bar to ascertain such value is or is not a proper one, . . . we are under no obligation to inquire upon the complainants' request. The method of valuation was one which they fully approved, and

this kind there is no proper basis for ascertaining its value, and the claim is evidently an afterthought."

<sup>1</sup> *Washburn v. National Wall Paper Co.*, 81 Fed. 19 (1897).

which was applied in fixing the value of their own property. . . . They certainly, participating in the transaction, and reaping its benefits, are in no position now to claim that the good-will bought by the defendant company with common stock was overvalued."

§ 321. **Over-valuation of Property acquired by Issue of Stock.**

— The formation of every corporate combination is in the nature of an experiment, entered into for the anticipated benefit of the owners of the several establishments entering the combination. The stock of the new corporation is, necessarily, of uncertain value. The valuation to be placed upon the various plants and the good-will of the business of each company cannot be reached by the application of any hard and fast rule.

In determining the amount of stock to be issued for property, including good-will, under such circumstances, the only requirement is that the contracting parties shall act in good faith in the transaction. As said by Judge Bunn in *Dickerman v. Northern Trust Co.*:<sup>1</sup> "Assuming that the stock of the new company was of par value, and that the plants were worth only the prices fixed upon them in the several options, of course there would appear to be an over-valuation in the sale. But this is an assumption that would scarcely be warranted. Probably there was not much market value for the stock, especially the common and unpreferred stock. It was supposed that the new enterprise would make the plants more valuable, so that the value of any plant before the transfer would not be evidence of its value after the consolidation should be completed. Every one interested proceeded with his eyes open, and it was entirely competent to make such a contract as they might agree upon. There was no compulsion practised and no evidence of fraud. The mill owners could set such valuation upon their plants as they chose, or as they could agree upon with those taking the options. The holders of options and the new company, in the absence of fraud, could do the same thing and make such bargain for the transfer as they saw fit."

When stock has been issued as fully paid up, in exchange for property acquired, the weight of authority supports the

<sup>1</sup> *Dickerman v. Northern Trust Co.*, 80 Fed. 453 (1897).

view that mere over-valuation is not sufficient to invalidate the issue, and that fraud, actual or constructive, must be shown;<sup>1</sup> and the same rule is sometimes provided by statute.<sup>2</sup>

<sup>1</sup> I. *Cases holding that, unless the over-valuation of the property is intentional and, consequently, fraudulent, the issue of stock cannot be attacked or the stock treated as only partially paid up.*

*United States:* Coit v. Gold Amalgamating Co., 119 U. S. 345 (1886), (7 Sup. Ct. Rep. 231); Dickerman v. Northern Trust Co., 80 Fed. 450 (1897); Northwestern Mut. Life Ins. Co. v. Exchange Real Est. Co., 70 Fed. 157 (1895); Du Pont v. Tilden, 42 Fed. 87 (1890); Phelan v. Hazard, 5 Dill. 45 (1878).

*Indiana:* Bruner v. Brown, 139 Ind. 600 (1894), (38 N. E. Rep. 318); Coffin v. Ransdell, 110 Ind. 417 (1887), (11 N. E. Rep. 20).

*Maryland:* Brant v. Ehlen, 59 Md. 1 (1882).

*Michigan:* Young v. Erie Iron Co., 65 Mich. 111 (1887), (31 N. W. Rep. 814).

*Minnesota:* Hastings' Malting Co. v. Iron Range Brew. Co., 65 Minn. 28 (1896), (67 N. W. Rep. 653).

*Nebraska:* Troup v. Horbach, 53 Neb. 795 (1898), (74 N. W. Rep. 326). Compare Gilkie, etc. Co. v. Dawson, etc. Co., 46 Neb. 333 (1895), (64 N. W. Rep. 978).

*New Jersey:* Bickley v. Schlag, 46 N. J. Eq. 533 (1890), (20 Atl. Rep. 250). See, however, Weatherby v. Baker, 35 N. J. Eq. 501 (1882).

*New York:* Seymour v. Spring Forest Cem. Ass'n, 144 N. Y. 333 (1895), (39 N. E. Rep. 365, 26 L. R. A. 859); Schenck v. Andrews, 57 N. Y. 133 (1874); Powers v. Knapp, 85 Hun, 38 (1895), (32 N. Y. Supp. 622).

*North Carolina:* Clayton v. Ore Knob Co., 109 N. C. 385 (1891), (14 S. E. Rep. 36).

*Pennsylvania:* American Tube, etc. Co. v. Hays, 165 Pa. St. 489

(1895), (30 Atl. Rep. 936); Carr v. Le Fevre, 27 Pa. St. 413 (1856).

*Tennessee:* Kelley v. Fletcher, 94 Tenn. 1 (1895), (28 S. W. Rep. 1099); Jones v. Whitworth, 94 Tenn. 602 (1895), (30 S. W. Rep. 736).

*Washington:* Kroenert v. Johnston, 19 Wash. 96 (1898), (52 Pac. Rep. 605).

*England:* *In re Wragg*, 1 Ch. Div. 796 (1897); Curries Case, 3 De Gex, J. & S. 367 (1863).

*Canada:* *In re Hess Mfg. Co.*, 23 Can. S. C. 644 (1894).

II. *Cases holding that proof of over-valuation, even without fraud, leaves the stock only paid up to the extent of the true value.*

*United States:* Altenburgh v. Grant, 85 Fed. 345 (1897), construing peculiar provision of Kentucky constitution.

*Alabama:* Roman v. Dimmick, 115 Ala. 233 (1897), (22 So. Rep. 109).

*Illinois:* Sprague v. National Bank, 172 Ill. 149 (1898), (50 N. E. Rep. 19, 64 Am. St. Rep. 17).

*Missouri:* Van Cleve v. Berkey, 143 Mo. 109 (1898), (44 S. W. Rep. 743, 42 L. R. A. 593).

*Ohio:* Gates v. Tippecanoe Stone Co., 57 Ohio St. 60 (1897), (48 N. E. Rep. 285, 63 Am. St. Rep. 705).

*Utah:* Salt Lake Hardware Co. v. Tintic Mill. Co., 13 Utah, 423 (1896), (45 Pac. Rep. 200).

<sup>2</sup> *New Jersey Corporation Act of 1896*, § 49, p. 293. See note to § 319, *ante*.

A wilful disregard of the rule prescribed by this statute, involving an intentional over-valuation of property acquired by a corporation, is fraud within the meaning of the statute and the issuing of stock without an appraisal of the actual cost value of such property is illegal.

Gross and obvious over-valuation would, however, make the transaction presumptively fraudulent.<sup>1</sup>

Constitutional provisions have been adopted and statutes enacted, in many States, against the fictitious issue of stock. A consideration of these provisions, and of the remedies of creditors or stockholders in the case of watered stock, belongs more appropriately in a treatise upon general corporation law.

§ 322. **Power of Vendor Corporations to sell Properties for Stock of Purchasing Corporation.** — The general principles of law governing the exchange of corporate property for stock in other corporations, which have already been fully considered, are applicable in the case of the formation of a corporate combination and do not require further examination.<sup>2</sup>

§ 323. **Corporate Combinations through Formation of Holding Corporations.** — Corporate combinations have sometimes been created by the formation of a corporation to acquire control of several competing corporations, through the ownership of a majority of their respective shares.

Upon principles elsewhere considered, such holding corporations can only be organized under laws permitting corporations to acquire and hold stock in other corporations. A corporate combination by means of a holding corporation, therefore, depends for its validity upon the power of such corporation to hold the shares of the several subsidiary companies. In the absence of such power, the combination is invalid, and the holding corporation is liable to be proceeded against in *quo warranto*, entirely irrespective of the question whether the combination is opposed to public policy.<sup>3</sup>

Strickland v. National Salt Co., 64 Atl. Rep. 982 (N. J. Ch. 1906).

<sup>1</sup> Coit v. Gold Amalgamating Co., 119 U. S. 343 (1886), (7 Sup. Ct. Rep. 231); Lloyd v. Preston, 146 U. S. 630 (1892); Coleman v. Howe, 154 Ill. 458 (1895), (39 N. E. Rep. 725, 45 Am. St. Rep. 133); Hastings Malting Co. v. Iron Range Brew. Co., 65 Minn. 28 (1896), (67 N. W. Rep. 652).

<sup>2</sup> See *ante*, subdiv. II. ch. 11: "*Exchange of Property of One Corporation for Stock of Another.*" See also *ante*,

§ 281: "*Power to take Stock in Exchange for Corporate Assets.*"

<sup>3</sup> People v. Chicago Gas Trust Co., 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497), is, perhaps, the leading case illustrating the principles governing this form of corporate combination.

For examination of this case, see *post*, § 346: "*Basis of Rule — (E) Case of the Chicago Gas Trust.*"

See also *ante*, § 264: "*Necessity for Statutory Authority to purchase Stock. Rule in United States.*"

## ARTICLE II

COMBINATIONS AS AFFECTED BY PRINCIPLES OF  
COMMON LAW AND PUBLIC POLICY

## CHAPTER XXXI

## APPLICATION OF LAW OF CONSPIRACIES

- § 324. Definition and Classification of Conspiracies.  
 § 325. Criminal and Civil Conspiracies distinguished.  
 § 326. Applicability of Law of Conspiracies to Corporations.  
 § 327. What Combinations are Conspiracies.  
 § 327a. Remedies and Procedure in Case of Conspiracies.  
 § 328. Modern Combinations of Capital seldom Conspiracies.

§ 324. **Definition and Classification of Conspiracies.** — A conspiracy is a species of the genus combination, and may be broadly defined as a combination to effect an illegal object, as an end or means; or, in the language of Lord Denman,<sup>1</sup> "to do an unlawful act, or a lawful act by unlawful means."<sup>2</sup>

<sup>1</sup> Jones' Case, 4 B. & Ad. 349 (1832).

<sup>2</sup> *United States v. Pettibone*, United States, 148 U. S. 203 (1893), (13 Sup. Ct. Rep. 542): "A conspiracy is sufficiently described as a combination of two or more persons, by concerted action, to accomplish a criminal or unlawful purpose, or some purpose not in itself criminal or unlawful, by criminal or unlawful means." See also *United States v. Cassidy*, 67 Fed. 698 (1895).

*Georgia. Brown v. Jacobs' Pharmacy Co.*, 115 Ga. 429, 433 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547): "A conspiracy has been defined as a combination either to accomplish an unlawful end, or to accomplish a lawful end by unlawful means."

*Illinois. Smith v. People*, 25 Ill. 17 (1860), (76 Am. Dec. 780).

*Maine. State v. Bartlett*, 30 Me. 134 (1849): "A conspiracy at common law consists in the unlawful agreement of two or more persons to compass or promote some criminal or illegal purpose, or in the unlawful agreement to compass or promote a purpose not in itself criminal or unlawful, by criminal or unlawful means."

*Maryland. Klingel's Pharmacy v. Sharp*, 104 Md. 230 (1906), (64 Atl. Rep. 1029): "A combination is a conspiracy in law whenever the act to be done has a necessary tendency to prejudice the public, or oppress individuals by unjustly subjecting them to the power of the confederation and giving effect to the purposes



Conspiracies are of two kinds, criminal and civil. A criminal conspiracy is a combination of two or more persons to accomplish, by concerted action, a criminal or unlawful object; or a lawful object, by criminal or unlawful means.<sup>1</sup>

of the latter, whether of extortion or mischief."

*Massachusetts.* Commonwealth v. Waterman, 122 Mass. 57 (1877): A conspiracy is "the combination of two or more [persons] to do something unlawful, either as a means or as an ultimate end."

*Michigan.* Alderman v. People, 4 Mich. 414 (1857), (69 Am. Dec. 321).

*West Virginia.* There can be no conspiracy to do that which is lawful by lawful means.

Porter v. Mack, 50 W. Va. 581 (1901), (40 S. E. Rep. 459).

See also West Virginia Trans. Co. v. Standard Oil Co., 50 W. Va. 611 (1902), (40 S. E. Rep. 591, 88 Am. St. Rep. 895).

The Texas anti-trust statute of 1903 (§ 3) contains a definition of a conspiracy in restraint of trade.

<sup>1</sup> See definitions in preceding note.

In Commonwealth v. Hunt, 4 Met. (Mass.) 123 (1842), Chief Justice Shaw thus defined a criminal conspiracy: "A conspiracy must be a combination of two or more persons, by some concerted action, to accomplish some criminal or unlawful purpose, or to accomplish some purpose, not criminal or unlawful, by criminal or unlawful means."

The term "unlawful," in addition to the term "criminal," was used, said the Chief Justice, because "it is manifest that many acts are unlawful which are not punishable by indictment or other public prosecution; and yet there is no doubt, we think, that a combination by numbers to do them would be an unlawful conspiracy, and punishable by indictment."

As to the use of the phrase "by

concerted action," see United States v. Cassidy, 67 Fed. 698 (1895); Alderman v. People, 4 Mich. 424 (1857), (69 Am. Dec. 321).

The manifest difficulty of stating a rule for determining what acts, unlawful but not criminal when committed by an individual, constitute a criminal offence when committed by a combination of individuals, was considered by the Supreme Court of Errors of Connecticut in State v. Glidden, 55 Conn. 70 (1887), (8 Atl. Rep. 890): "It has often been said that a conspiracy to effect an unlawful purpose, or a lawful purpose by unlawful means, is an offence. But this is said to be a limitation rather than a definition. It certainly lacks definiteness. Many acts are said to be unlawful which would not be the subject of a criminal conspiracy. Other acts are unlawful because they are in violation of the criminal law or some penal statute. If the end or means are criminal in themselves, or contrary to some penal statute, the conspiracy is clearly an offence. Between these two extremes a great variety of cases may arise, many of which ought not to be regarded as criminal. . . . If we were to attempt to give a rule applicable to this branch of the subject, we should say that it is a criminal offence for two or more persons, corruptly or maliciously to confederate and agree together to deprive another of his liberty or property. Such a rule is proximately correct and practically just."

The theory that acts merely unlawful may become criminal when done in concert is supported by the authorities to such an extent that the writer has

A civil conspiracy is a combination of two or more persons to accomplish, by concerted action, an unlawful or oppressive object; or a lawful object, by unlawful or oppressive means — resulting in damage.<sup>1</sup>

§ 325. **Criminal and Civil Conspiracies distinguished.** — A criminal and a civil conspiracy, aside from the element of criminality, may be distinguished from the fact that the gist of the action in case of the one is merely an act of aggravation in the other.<sup>2</sup>

The gist of the offence of criminal conspiracy is the *combination*. The offence is complete when the confederacy is made, and no overt act is necessary. Any act in pursuance of the combination is matter of aggravation.<sup>3</sup>

felt obliged to follow it in formulating a definition of a criminal conspiracy. It is difficult, however, to support it upon principle. Mere concert of action — except when involving force or false statement — is not, in itself, criminal; and if neither the object nor means are criminal wherein lies the criminality? See, in this connection, *Bohn Mfg. Co. v. Hollis*, 54 Minn. 223 (1893), (55 N. Rep. 119); *Rourke v. Elk Drug Co.*, 75 App. Div. (N. Y.) 145 (1902), (78 N. Y. Supp. 1135).

It is not necessary that the object of a criminal conspiracy should constitute a criminal offence.

*Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770).

<sup>1</sup> The same combination, of course, may amount to a criminal as well as a civil conspiracy. Acts constituting a criminal conspiracy, if accompanied with damage, may also subject the conspirators to a civil action.

For consideration of the element of damage in civil conspiracies, see next section.

<sup>2</sup> In *Van Horn v. Van Horn*, 52 N. J. L. 286 (1890), (20 Atl. Rep. 485, 10 L. R. A. 184), the Court said: "It is not necessary to consider the office of the ancient writ of conspiracy,

and the process by which, in time, it was superseded by the later and more efficacious action on the case for conspiracy, and the still more modern action for malicious prosecution. Nor will it now be advantageous to show how long and difficult it was to separate the idea of a criminal conspiracy at common law, where the agreement or conspiracy was the *gravamen* of the offence, from the real complaint in a civil action, that the combination of two or more persons has enabled them to inflict a great wrong on the plaintiff. The combination or conspiracy in the latter case was, therefore, a matter of aggravation or inducement only, of which one or all might be found guilty, while in the former it was essential to show that two or more had joined in an agreement to do an unlawful act, or to do a lawful act in an unlawful manner. The distinction is now well established, that in civil actions the conspiracy is not the *gravamen* of the charge."

<sup>3</sup> *Commonwealth v. Judd*, 2 Mass. 329 (1807), (3 Am. Dec. 54) (*per Parsons, C. J.*): "The gist of a conspiracy is the unlawful confederacy to do an unlawful act, or even a lawful act for unlawful purposes; the offence is complete when the con-

*Damage* is essential to a right of action for civil conspiracy. It is the gravamen of the charge, and the combination is only a matter of aggravation.<sup>1</sup>

### § 326. Applicability of Law of Conspiracies to Corporations.

— The law of civil conspiracies is equally applicable to corporations and to individuals. A combination of corporations for an unlawful or oppressive object — as an end or means —

federacy is made; and any act done in pursuance of it is no constituent part of the offence, but merely an aggravation of it. The rule of the common law is to prevent unlawful combinations. . . . The unlawful confederacy is, therefore, punished to prevent the doing of any act in execution of it."

*People v. Sheldon*, 139 N. Y. 264 (1893), (34 N. E. Rep. 785, 36 Am. St. Rep. 690, 23 L. R. A. 221): "The gravamen of the offence of conspiracy is the combination. Agreements to prevent competition in trade are, in contemplation of law, injurious to trade, because they are liable to be injuriously used."

Both of these opinions refer to *criminal* conspiracies and are indicative of the uniform current of authority that, unless expressly provided by statute (as is sometimes the case), proof of an overt act is not necessary in a prosecution for conspiracy; nor is it necessary to set forth such act in the indictment.

<sup>1</sup> *Robertson v. Parks*, 76 Md. 135 (1892), (24 Atl. Rep. 413): "It is a general rule, that a conspiracy cannot be made the subject of a civil action, unless something is done which, without the conspiracy, would give a right of action. The damage done is the gist of the action, not the conspiracy. Where the mischief contemplated is accomplished, the conspiracy becomes important, as it may affect the means and measures of redress. The party wronged may look beyond the actual participants in committing the in-

jury, and join with them as defendants all who conspired to accomplish it; and the fact of conspiracy may aggravate the wrong; but the simple act of conspiracy does not furnish a substantial ground of action."

*Doremus v. Hennessey*, 62 Ill. App. 402 (1895): "A civil action will not lie for a mere conspiracy. It is the damage done in pursuance of the conspiracy which gives the right of action. It is now well established that, in civil actions, the conspiracy is not the gravamen of the charge, but may be pleaded and proved in aggravation of the wrong of which the plaintiff complains, and as enabling him to recover against all the conspirators, as joint tortfeasors."

The damage and not the wrongful confederation is the gist of the action for civil conspiracy. In order to state a cause of action for such a conspiracy the facts from which the damage has resulted must be alleged as well as the confederation and conspiracy.

*Commercial Union Ins. Co. v. Shoemaker*, 65 Neb. 173 (1901), (88 N. W. Rep. 156).

See also *Adler v. Fenton*, 24 How. (U. S.) 407 (1860); *Van Horn v. Van Horn*, 52 N. J. L. 284 (1890), (20 Atl. Rep. 485, 10 L. R. A. 184); *Kimball v. Harman*, 34 Md. 407 (1871), (6 Am. Rep. 340); *Stevens v. Rowe*, 59 N. H. 578 (1880), (47 Am. Rep. 231); *Hutchins v. Hutchins*, 7 Hill, 104 (1845).

is a conspiracy, if a similar combination of natural persons would amount to a conspiracy; and the converse of the proposition is equally true.

In *Buffalo Lubricating Oil Co. v. Standard Oil Co.*,<sup>1</sup> the Court said: "We entertain no doubt that an action against a corporation may be maintained to recover damages caused by conspiracy. . . . If actions can be maintained against corporations for malicious prosecution, libel, assault and battery, and other torts, we can perceive no reason for holding that actions may not be maintained against them for conspiracy. It is well settled by the authorities cited, that the malice and wicked intent needful to sustain such actions may be imputed to corporations."<sup>2</sup>

Upon similar principles, it seems clear that a combination of corporations for a criminal object would amount to a criminal conspiracy, if such would be the result of a combination of individuals for the same purpose. In several States, the anti-trust laws expressly provide that corporations, as well as natural persons, violating their provisions, shall be guilty of the crime of conspiracy.<sup>3</sup>

<sup>1</sup> *Buffalo Lubricating Oil Co. v. Standard Oil Co.*, 106 N. Y. 670 (1887), (12 N. E. Rep. 826).

<sup>2</sup> In *West Virginia Trans. Co. v. Standard Oil Co.*, 50 W. Va. 611 (1902), (40 S. E. Rep. 591), 88 Am. St. Rep. 895, the Court said: "It is very clear that a corporation can be guilty of a combination or conspiracy with other corporations or persons aimed at and accomplishing the injury of other corporations or persons. It is a mere legal entity and itself is incapable of so doing; but it is moved by human beings, is operated by human agents, and is thus an active person not only for damage done in the breach of contracts, but for torts doing others harm."

<sup>3</sup> The *Missouri* anti-trust act (see *post*, ch. XLI.) provides in its first section that any corporation, individual or other association of persons, entering into any combination in

violation of its provisions, "shall be deemed and adjudged guilty of a conspiracy to defraud." In *National Lead Co. v. Grote Paint Store Co.*, 80 Mo. App. 247 (1899), the Missouri Court of Appeals, referring to this statute, said: "By the language of the first section of that enactment a violation of its provisions is made a crime, *i.e.* 'a conspiracy to defraud.'" And in discussing the liability of a corporation for its violation the Court said (p. 269): "A corporation can only act through its members or their agents. The corporate entity with which the law clothes it for special purposes is not self-acting, hence there was no thought of its action alone in the mind of the framers of the statute. The evident purpose of the legislature was to specify certain acts, which, if done by its stockholders or governing bodies, should constitute a crime on the part of the corporation."

§ 327. **What Combinations are Conspiracies.** — A combination amounts to a criminal conspiracy only when the end or means are criminal or unlawful. A combination amounts to a civil conspiracy only when the ends or means are unlawful or oppressive, and the legal rights of others are infringed. Whether a particular combination is a conspiracy depends, therefore, upon its object, and the means adopted for accomplishing it. The question of motive may also be of importance.<sup>1</sup>

Thus in the celebrated *Mogul Steamship Case*<sup>2</sup> Lord Chief

It did not contemplate the commission of an offence by an impalpable abstraction, which could neither think nor act; but it intended to bind this corporate entity by the imputed actions of its human agencies."

In *State v. Firemen's Fund Ins. Co.*, 152 Mo. 37 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363), the Supreme Court of Missouri discussed the applicability of the same law to insurance companies: "It could not be tolerated for a moment that an insurance company could hide under the skirts of its agents and violate the anti-trust laws of our State with impunity. . . . The company can and must control its agents, and must see, at its peril, that its agents do not violate the law while attending to the business of the company. This is the rule as to libels, assaults, malicious torts by agents of incorporated companies, and there is greater reason for it being the true rule in cases involving the anti-trust laws."

That a corporation cannot be indicted for making an unlawful agreement in restraint of competition does not stand in the way of counting it as a party to such a conspiracy.

*Standard Oil Co. v. State* (Tenn., 1907), 100 S. W. Rep. 705.

<sup>1</sup> In *Hawarden v. Youghioghenny, etc. Coal Co.*, 111 Wis. 545 (1901), (87 N. W. Rep. 472, 55 L. R. A. 828) the Court held that while persons have a right to combine in a legiti-

mate way yet that where the object of a combination is to inflict injury upon others and injury results, a wrong is committed for which the injured person may recover damages. In this case the business of a retail coal dealer had been destroyed by combination between wholesale dealers and certain retail dealers for the purpose of forcing out of business all retailers not parties thereto.

<sup>2</sup> *Mogul Steamship Co. v. McGregor*, L. R. 21 Q. B. 552 (1888). This is the leading case upon the law of conspiracies as applied to trade competition, and, in its various stages, is reported in L. R. 15 Q. B. 476 (1885), L. R. 21 Q. B. 544 (1888), L. R. 23 Q. B. 598 (1889), L. R. 17 App. Cas. (1891) 25. In this case certain owners of steam vessels trading between China and England, for the purpose of obtaining a monopoly of the homeward tea trade and maintaining the rates of freight thereon, formed an association, and offered to all shippers of tea who used exclusively the vessels of members of the association a rebate of five per cent on all freights. The plaintiffs, who were rival ship owners, were excluded from the benefits of the association to their damage, as alleged, and they instituted an action for the recovery of damages and for an injunction. The gist of the plaintiffs' case, as stated, was a *conspiracy* on the part of the respondents to prevent the plaintiffs from obtaining

Justice Coleridge said: "I do not doubt the acts done by the defendants here, if done wrongfully and maliciously, or if done in furtherance of a wrongful and malicious combination, would be ground for an action on the case at the suit of one who has suffered injury from them. The question comes at last to this: What was the character of those acts, and what was the motive of the defendants in doing them?"

A combination entered into for the malicious purpose of injuring a person in his business may amount to a conspiracy, and furnish a ground of action for the damage sustained. The essential element of a conspiracy — the unlawful end or means — may be the intentional doing of acts detrimental to the business of a competitor, without justification or excuse. But combinations without such ulterior object, and merely for the purpose of promoting, by lawful means, the common interests of the parties, are not conspiracies. A trader or manufacturer has the right to push his trade or business in a lawful manner, although his success may necessarily involve loss to his competitors. So, several traders and manufacturers may combine for mutual advantage and, so long as the *motive* is not malicious, the *object* not unlawful or oppressive, and the *means* neither deceitful nor fraudulent, the result is not a conspiracy, although it may necessarily work injury to other persons engaged in the same business. The essential question is whether the object of a combination is to do harm to others or to exercise the rights of the association for its own benefit.<sup>1</sup>

cargoes for their steamers. A motion for a preliminary injunction was denied (L. R. 15 Q. B. 476) (1885), upon the ground that, although a conspiracy to obtain a monopoly of a carrying trade might constitute an actionable conspiracy, irreparable damage warranting an injunction had not been shown. The case then came before Lord Coleridge (C. J.), who held (L. R. 21 Q. B. 544) (1888), that the essential element of "*unlawfulness*" in the combination had not been shown and rendered judgment for the defendants. The case then went to the Court of Appeal, which,

by a majority of its members, held that the association, being formed by the defendants merely for the purpose of winning trade and without any malice or ill-will towards the plaintiffs or with the intention of ruining their trade, did not constitute a conspiracy, and rendered judgment for the defendant. The case was then taken to the House of Lords and the judgment affirmed upon the same grounds (L. R. 17 App. Cas. (1891) 25).

<sup>1</sup> In the *Mogul Steamship Case* (L. R. 23, Q. B. 614) (1889), Lord Justice Bowen of the Court of Appeal

Whether the purpose of a combination is unlawful or oppressive does not wholly depend upon whether such purpose if formed and carried out by an individual would be unlawful or oppressive. The doing of an act by a number of persons may give it an impulse and injurious effect far beyond that which could possibly result from the act of a single

considered at length the principles stated in the text: "What, then, are the limitations which the law imposes on a trader in the conduct of his business as between himself and other traders? There seems to be no burdens or restrictions in law upon a trader which arise merely from the fact that he is a trader, and which are not equally laid on all other subjects of the crown. His right to trade freely is a right which the law recognizes and encourages, but it is one which places him at no special disadvantage as compared with others. No man, whether trader or not, can, however, justify damaging another in his commercial business by fraud or misrepresentation. . . . But the defendants have been guilty of none of these acts. They have done no more against the plaintiffs than pursue to the bitter end a war of competition waged in the interest of their own trade. . . . I can find no authority for the doctrine that such a commercial motive deprives of 'just cause for excuse' acts done in the course of trade which would but for such motive be justified. So to hold would be to convert into an illegal motive the instinct of self-advancement and self-protection, which is the very incentive to all trade. . . . It is urged, however, on the part of the plaintiffs, that even if the acts complained of would not be wrongful had they been committed by a single individual, they become actionable when they are the result of concerted action among several. In other words, the plaintiffs, it

is contended, have been injured by an illegal conspiracy. Of the general proposition, that certain kinds of conduct not criminal in any one individual may become criminal if done by combination among several, there can be no doubt. The distinction is based on sound reason, for a combination may make oppressive or dangerous that which if it proceeded only from a single person would be otherwise, and the very fact of the combination may show that the object is simply to do harm, and not exercise one's own just rights. . . . The question to be solved is whether there has been any such [illegal] agreement here. Have the defendants combined to do an illegal act? Have they combined to do a lawful act by an unlawful means? A moment's consideration will be sufficient to show that this new inquiry only drives us back to the circle of definitions and legal propositions which I have already traversed in the previous part of this judgment. The unlawful act agreed to, if any, between the defendants must have been the intentional doing of some act to the detriment of the plaintiffs' business without just cause or excuse. Whether there was any such justification or excuse for the defendants is the old question over again, which, so far as regards an individual trader, has been already solved. The only *differentia* that can exist must arise, if at all, out of the fact that the acts done are the joint acts of several capitalists, and not of one capitalist only."

person.<sup>1</sup> Thus the mere refusal by one person to sell to another is not actionable whatever his motive may be.<sup>2</sup> But where the wholesale and retail dealers in a commodity in a given locality enter into a combination not to deal with retailers who do not join with them, the combination may amount to a conspiracy and persons injured may recover damages from the conspirators.<sup>3</sup>

<sup>1</sup> *Hawarden v. Youghiogeny, etc.* Coal Co., 111 Wis. 545 (1901), (87 N. W. Rep. 472, 55 L. R. A. 828). See also extract from opinion in *Mogul Steamship* case in last note.

<sup>2</sup> *Wills v. Central Ice, etc. Co.*, (Tex. Civ. App. 1905), 88 S. W. Rep. 265.

*Brewster v. Miller's Sons Co.*, 101 Ky. 368 (1897), (41 S. W. Rep. 301): "It is part of every man's civil rights that he be left at liberty to refuse business relations with any person whomsoever, whether the refusal rests upon reason, or is the result of whim, caprice, prejudice, or malice. With his reasons neither the public nor third persons have any legal concern, and the exercise by him of his legal rights cannot be a legal wrong to another. Appellant brought this action against certain members of the Funeral Directors Association to recover damage, alleging that they and other members of that association had refused to furnish him the articles, or render the services necessary for the burial of his wife, said refusal being based upon the ground that appellant was indebted to some member of the said association for the burial services of his father, and that, therefore, under the rules of said association no member thereof was permitted to furnish such services until said indebtedness was satisfied. And it is held that while the members of the association might be guilty of a public offence, and a violation of the provisions of ch. 101, of the Kentucky Statutes, if proceeded against by an indictment, yet appellant

having asserted no claim for damages to personal character or a business reputation resulting from such alleged acts of conspiracy, cannot maintain his action."

<sup>3</sup> *Hawarden v. Youghiogeny, etc.* Coal Co., 111 Wis. 545 (1901), (87 N. W. Rep. 472, 55 L. R. A. 828).

A combination between independent producers to regulate and fix the price at which coal should be sold in a certain territory, and to prevent competition in its sale, amounts to a common law conspiracy.

*Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904).

Where wholesale and retail druggists in a city formed a combination to maintain prices, and in pursuance thereof, refused to sell to a retail dealer who had declined to join the combination, and threatened and intimidated other wholesale dealers into refusing to deal with him, it was held that the combination was a conspiracy.

*Klingel's Pharmacy v. Sharp*, 104 Md. 218 (1906), (64 Atl. Rep. 1029, 7 L. R. A. (n. s.) 976).

See also *Ferd Heim Brewing Co. v. Belinder*, 97 Mo. App. 64 (1903), (71 S. W. Rep. 691).

An agreement between a brick-layers' union, a builders' association and a brick manufacturers' association, that they will not buy or lay brick made by any manufacturer not subscribing to the rules of the builders' association, with the object of injuring the business of such manufacturer, is a conspiracy and unlaw-



§ 327a. **Remedies and Procedure in Case of Conspiracies.** — Corporations and individuals entering into a combination amounting to a criminal conspiracy are subject to indictment and punishment in the same manner as if guilty of other offences. The only limitation with respect to corporations — and this obviously applies to all offences — is that they cannot be imprisoned.

An indictment charging certain corporations with conspiracy, and alleging that its object was unlawful sufficiently charges a conspiracy at common law without setting out the means by which the conspiracy was to have been accomplished.<sup>1</sup>

In order to establish a criminal conspiracy to fix the price of a commodity it is not necessary to show that the combination was formally entered into or evidenced by a written agreement. An understanding among the conspirators to work a common

ful and the parties are liable for all damages resulting therefrom. And it is not necessary to show that the particular acts complained of, were done directly by all the conspirators. If done by some of them after the formation of the combination, or by agents in carrying out its objects, all are liable.

*Purington v. Hinchliff*, 219 Ill. 159 (1905), (76 N. E. Rep. 47), *affirming* 120 Ill. App. 523 (1905).

A complaint charging a combination between certain railroad companies and an association of elevator owners in pursuance of which the railroad companies refuse to carry grain sent through the plaintiff's elevator which is well located except at an advance over the rate charged for grain sent through the elevators of members of the association, and by which certain shippers have been prevented from shipping a certain amount of grain through the plaintiff's elevator, states a cause of action for civil conspiracy.

*Kellogg v. Lehigh Valley R. Co.*, 61 App. Div. (N. Y.) 35 (1901), (70 N. Y. Supp. 237).

For consideration of combinations of bidders at public sales amounting to conspiracies in restraint of trade see *In re Blake*, 150 Fed. 279 (1906).

For consideration of trade agreements amounting to conspiracies see *National Fire Proofing Co. v. Master Builders' Ass'n*, 145 Fed. 263 (1906); *Curran v. Galen* 152 N. Y. 33 (1897), (46 N. E. Rep. 296, 57 Am. St. Rep. 496, 37 L. R. A. 802), and cases cited.

<sup>1</sup> *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904).

An indictment for criminal conspiracy in pooling, and fixing the price of an article of commerce, must state the names of all the parties to such conspiracy known to the prosecution, but all the parties need not be jointly indicted.

*State v. Dreany*, 65 Kan. 292 (1902), (69 Pac. Rep. 182).

It must be borne in mind in considering this section that the subject under consideration is common law conspiracies and that most of the recent prosecutions for trade conspiracies have been under State anti-trust statutes. See *post*, ch. XLIII.

purpose is all that is necessary. And the evidence should be directed toward showing what has been actually accomplished under the understanding rather than its professed object.<sup>1</sup>

The offence of criminal conspiracy is committed when the unlawful combination is formed, and after it is formed the acts of the different members which tend to further its purposes bind all the members.<sup>2</sup>

With respect to civil conspiracies — “No person or combination of persons can legally, by direct or indirect means, obstruct or interfere with another in the conduct of his lawful business, and any loss wilfully caused by such interference will give the party injured a right of action for all damages sustained. All parties to a conspiracy to ruin the business of another because of his refusal to do some act against his will or judgment are liable for all overt acts illegally done pursuant to such conspiracy and for the subsequent loss, whether they were active participants or not.”<sup>3</sup>

<sup>1</sup> Chicago, etc. Coal Co. v. People, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904). It was also held in this case that the common law relating to criminal conspiracies has not been superseded in *Illinois* by the statutes upon the subject. See also Sanford v. People, 121 Ill. App. 619 (1905); People v. Aachen, etc. Fire Ins. Co., 126 Ill. App. 640 (1906).

In order to convict a defendant upon a charge of criminal conspiracy, it must be clearly shown that he knew of, and participated in, the conspiracy.

State v. Dreany, 65 Kan. 292 (1902), (69 Pac. Rep. 182).

<sup>2</sup> Chicago, etc. Coal Co. v. People, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904).

See also Ford v. Chicago Milk Shippers' Ass'n, 155 Ill. 166 (1895), (39 N. E. Rep. 651, 27 L. R. A. 298).

<sup>3</sup> Purington v. Hinchliff, 219 Ill. 159 (1905), (76 N. E. Rep. 47).

A person who has been a member of an illegal combination and has

participated in making rules for carrying out its purposes, but who has been suspended for violating such rules, may maintain an action against the combination and its members for damages caused by boycotting him after his suspension. It was held that he was not *in pari delicto* because the acts complained of were committed after his suspension.

Ertz v. Produce Exch. Co., 82 Minn. 173 (1901), (84 N. W. Rep. 743).

*Compare* Gladish v. Kansas City Live Stock Exch., 113 Mo. App. 726 (1905), (89 S. W. Rep. 77) where it was held that a member expelled from an association was not entitled to an injunction to restrain the association from declining to have any further business relations with him. See also Froelich v. Musicians' Mut. Ben. Ass'n, 93 Mo. App. 383 (1902); O'Brien v. Musical, etc. Union, 54 Atl. Rep. 150 (N. J. Ch. 1903).

Where wholesale and retail dealers in a certain city formed a combination to maintain prices and, in pursuance of the plan, refused to sell to

In addition to an action for the recovery of damages caused by a conspiracy the corporation or person threatened with injury may obtain an injunction against the members of the combination to restrain them from carrying into effect the objects of the conspiracy.<sup>1</sup>

These remedies which are available to persons injured by a conspiracy mark an important distinction between combinations which amount to conspiracies and those which are opposed to public policy only. As we shall see, the courts treat combination agreements of the latter class as void and

the plaintiff, a retailer who had refused to join the combination, and coerced other dealers to refuse to deal with him it was held that the members of the corporation were liable to the plaintiff for the resulting injury to his business.

*Klingel's Pharmacy v. Sharp*, 104 Md. 218 (1906), (64 Atl. Rep. 1029, 7 L. R. A. (N. S.) 976).

In *Wills v. Central Ice, etc. Co.*, 88 S. W. Rep. 265 (Tex. 1905) it was held that a conspiracy cannot be made the subject of a civil action, notwithstanding damages may have resulted, unless some act is done which, without the conspiracy, would give a right of action.

<sup>1</sup> *Leonard v. Abner-Drury Brewing Co.*, 25 App. D. C. 161 (1905); *Brown v. Jacobs Pharmacy Co.*, 115 Ga. 429 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547).

*Union Pressed Brick Co. v. Chicago Hydraulic Pressed Brick Co.*, 31 Chicago Legal News 428 (1899): "A court of equity ought not to be permitted to enjoin crime as crime, because it has no criminal jurisdiction, and because the machinery of the criminal law is supposed to be adequate to prevent the same. But if the commission of such crime involves the loss of private property, the owner thereof should and can obtain redress for his loss in a court of common law where that relief is adequate. Where the commission of such crime

will entail property loss to a private citizen for which he has no adequate relief at common law, courts of equity should give redress to the person who may be made to suffer such irreparable injury."

*Walsh v. Ass'n. of Master Plumbers*, 97 Mo. App. 280, 293 (1902), (71 S. W. Rep. 455): "Applying the doctrine of these cases to the allegations of the petition, there can be no question that the agreement between the respondents is an illegal conspiracy and that its effect is to inflict a civil wrong upon appellant, and that this wrong is a continuing one and, according to all authorities, entitles the appellant to injunctive relief so far as a court of equity is authorized to administer it within the bounds of equitable jurisprudence. We think it is competent for the court to declare the agreement complained of illegal and void and to restrain the parties to the agreement from keeping its terms or demanding that they be kept, and thus leave the respondent corporations and each of them free to deal or not to deal with appellant as they may choose."

But it is held that a combination of brewers, forming an association, fixing the price of its products and controlling their disposition, cannot be declared void in equity at the suit of retail dealers having no contract with the association and selling the product of a brewing company sought

unenforceable, but not as illegal, in the sense of giving a right of action to third persons.<sup>1</sup>

§ 328. **Modern Combinations of Capital seldom Conspiracies.**

— A combination of industrial corporations for the promotion of their common interests, manifestly can possess the element of criminality only when entered into in violation of some penal statute, or when criminal means are employed; and such a combination becomes a conspiracy, in its civil aspect, only when the element of illegality or oppression is present.<sup>2</sup>

to be compelled to join the association. Such result can be only obtained through a suit by the government.

Leonard v. Abner-Drury Brewing Co., 25 App. D. C. 161 (1905).

In this case it was also held that while the federal anti-trust statute makes a conspiracy in restraint of trade a criminal offence and prescribes a punishment therefor, it does not substitute its remedy for ordinary equitable remedies where the acts complained work irreparable property damage.

<sup>1</sup> Brown v. Jacob's Pharmacy Co., 115 Ga. 433 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547): "The next position of the defendants, and the one which, on first presentation, seems to be the strongest defence on this part of the case, is that, at common law, contracts or agreements in general or unreasonable restraint of trade were merely void and unenforceable; that either party could defend against an action based on them; but that they were not illegal in such sense as to give a right of action to third parties. While there may be conflict among the authorities, it seems to us that some confusion might have been avoided by bearing in mind the distinction between a contract or agreement merely in restraint of trade as between the parties, and a combination or contract to stifle competition, or a conspiracy to ruin a competitor."

<sup>2</sup> Morris Run Coal Co. v. Barclay Coal Co., 68 Pa. St. 173 (1871), (8 Am. Rep. 159), is the leading case holding a combination of corporations for the suppression of competition a *conspiracy*. The reasoning of the Court, however, clearly places the illegality of the combination upon grounds of public policy rather than upon principles of the law of conspiracies.

In this case five Pennsylvania coal companies, which controlled the entire production of two mining regions, entered into an agreement relating to production and prices and appointed a supervising committee and a common sales agent. The committee had power to adjust prices and the amount of production of each company was limited. The Court held that the agreement was invalid and amounted to a conspiracy, saying (p. 186): "The effects produced on the public interests lead to the consideration of another feature of great weight in determining the illegality of the contract, to wit: the combination resorted to by these five companies. Singly, each might have suspended deliveries and sales of coal to suit its own interests, and might have raised the price, even though this might have been detrimental to the public interest. There is a certain freedom which must be allowed to every one in the management of his own affairs. When competition is left free, individual error

A combination of corporations *may* have for its ultimate or immediate object injury to the business of a competitor, or it may be brought about by fraudulent or deceitful means injuriously affecting the public.<sup>1</sup> Such a combination may be a conspiracy, but such combinations have little place in modern business life.

Combinations of capital — whether in the form of associations, trusts or corporate combinations — are formed for the supposed advantage of the associates. The object of the parties is to benefit themselves, not to injure others. The attainment of this object may injuriously affect competitors, but the combination does not, for that reason, become a conspiracy. “The truth is,” said Lord Justice Bowen in the *Mogul Steamship Case*,<sup>2</sup> “that the combination of capital for

or folly will generally find a correction in the conduct of others. . . . This combination has a power in its confederated form which no individual action can confer. The public interest must succumb to it, for it has left no competition free to correct its baleful influence. When the supply of coal is suspended the demand for it becomes importunate, and prices must rise. Or, if the supply goes forward, the price fixed by the confederates must accompany it. The domestic hearth, the furnaces of the ironmaster, and the fires of the manufacturer, all feel the restraint, while many dependent hands are paralyzed, and hungry mouths are stinted. The influence of a lack of supply or a rise in the price of an article of such prime necessity cannot be measured. It permeates the entire mass of the community, and leaves few of its members untouched by its withering blight. Such a combination is more than a contract, it is an offence. . . . In all such combinations, where the purpose is injurious or unlawful, the gist of the offence is the conspiracy. Men can often do by the combination of many what severally no one could accomplish, and even

what, when done by one, would be innocent.”

See also *People v. Sheldon*, 139 N. Y. 251 (1893), (34 N. E. Rep. 785, 36 Am. St. Rep. 690, 23 L. R. A. 221).

<sup>1</sup> *Fairbanks v. Leary*, 40 Wis. (643) (1876): “The law does not and did not require that these parties should compete in the purchase of produce. Individually each had an undoubted right to bid therefor as low as he pleased. Collectively, they had the same right, unless deception was practised on the public. But if they held themselves out as competing purchasers, and knew that the people who sold in the market where they operated relied upon such competition (as well they might), as a guaranty that they were obtaining the full market value of their produce, while, at the same time, the purchasers were not in competition, but in a secret league to depress the market, the agreement under which the latter operated is illegal and void, and no court will lend its aid to enforce any of its stipulations.” See also *Craft v. McConoughy*, 79 Ill. 346 (1875), (22 Am. Rep. 171).

<sup>2</sup> *Mogul Steamship Co. v. McGregor*, L. R. 23 Q. B. 617 (1889).

purposes of trade and competition, is a very different thing from such a combination of several persons against one, with a view to harm him, as falls under the head of an indictable conspiracy. There is no just cause or excuse in the latter class of cases. There is such a just cause or excuse in the former. There are cases in which the very fact of a combination is evidence of a design to do that which is hurtful, without just cause, — is evidence — to use a technical expression — of malice. But it is perfectly legitimate, as it seems to me, to combine capital for all the mere purposes of trade for which capital may, apart from combination, be legitimately used in trade. To limit combinations of capital, when used for purposes of competition, in the manner proposed by the argument of the plaintiffs, would, in the present day, be impossible — would be only another method of attempting to set boundaries to the tides.”

The fact that a combination, after its formation, may become a party to a conspiracy — may intentionally injure or oppress others — does not relate back to and invalidate the original combination agreement. The combination will be liable for the subsequent conspiracy, but the validity of its organization will depend solely upon the contract as made, and the facts and circumstances attending its execution.

The fact that a combination is against public policy does not make it a conspiracy. If contravening the rules of public policy it is invalid, and it is made no more invalid by designating it a conspiracy. The inexact use of terms in judicial decisions has occasioned much of the confusion attending the law of combinations.

## CHAPTER XXXII

## APPLICATION OF LAW OF MONOPOLIES

§ 329. Primary Meaning of Term "Monopoly."

§ 330. Growth of Monopolies — Their Illegality.

§ 331. No True Monopolies in United States. Patents and Other *Quasi-monopolies*.

§ 332. Modern Use of Term "Monopoly."

§ 333. Direct Test of Validity of Combination not whether it is a Monopoly.

§ 329. **Primary Meaning of Term "Monopoly."** — The meaning of the term "monopoly," used in a historic and exact sense, is best expressed in the early definition of Lord Coke: "A monopoly is an institution, or allowance by the king by his grant, commission, or otherwise, to any person or persons, bodies politicque, or corporate, of, or for, the sole buying, selling, making, working, or using of anything, whereby any person or persons, bodies politicque or corporate, are sought to be restrained of any freedome, or liberty that they had before, or hindred in their lawful trade."<sup>1</sup>

§ 330. **Growth of Monopolies — Their Illegality.** — Monopolies of the character described by Lord Coke were grants from the crown of exclusive rights to control the manufacture or sale of commodities and, while employed by earlier English sovereigns, reached their extreme development in the reign of Queen Elizabeth. She husbanded her own resources at the expense

<sup>1</sup> 3 Coke's Inst. 181. This definition of Lord Coke was quoted with approval by Justice Story in his dissenting opinion in the Charles River Bridge Case, 11 Pet. (U. S.) 606 (1837), and by Justice Field in his dissenting opinion in the Slaughter House Cases, 16 Wall. 102 (1872). See also arguments of Holt and Treby, afterwards Chief Justices of the King's Bench, as counsel, in the celebrated case of *East India Co. v. Sandys*, 10 How. State Tr. 371 (1684).

A monopoly is "a license or privi-

ledge allowed by the king for the sole buying and selling, making, working, or using of anything whatsoever; whereby the subject in general is restrained from that liberty of manufacturing or trading which he had before." 4 Blackst. Com. 159.

*Leeper v. State*, 103 Tenn. 500 (1899), (53 S. W. Rep. 962, 48 L. R. A. 170): "A 'monopoly' has been defined to be an exclusive right granted to a few of something which was before a common right."

of her people, and rewarded her favorites by grants of innumerable patents for monopolies. The natural result was an increase in price of the necessities of life. "There was scarcely a family in the realm," says Lord Macaulay,<sup>1</sup> "that did not feel itself aggrieved by the oppression and extortion which the abuse naturally caused. Iron, oil, vinegar, coal, lard, starch, yarn, leather, glass, could be bought only at exorbitant prices."

Relief first came from the courts, and in the great *Case of the Monopolies*,<sup>2</sup> decided during the reign of Queen Elizabeth, grants of monopolies were held to be void. The common law against monopolies, thus established, was reinforced, after the death of Elizabeth, by the Statute 21 James I. ch. 3, which provided that all grants of monopolies, with a few exceptions, were "altogether contrary to the laws of this realm and so are and shall be utterly void and of none effect and in no wise to be put in use or execution."

The English common law, including the Statute of James I. against monopolies, is the basis of American jurisprudence,<sup>3</sup>

<sup>1</sup> Macaulay's History of England, vol. 1, p. 58.

<sup>2</sup> *Darcy v. Allein*, Coke, Part 11, 86b (1602), (Noy, 173). In this case it was declared that a patent from Queen Elizabeth conferring upon Darcy the exclusive privilege of manufacturing playing cards for twenty-one years was a monopoly and void, as being against public policy. The Court stated the following incidents of monopolies:

(a) "The price of the same commodity will be raised, for he who has the sole selling of any commodity, may and will make the prices as he pleases. . . .

(b) "The second incident to a monopoly is that, after the monopoly is granted, the commodity is not so good and merchantable as it was before: for the patentee having the sole trade, regards only his private benefit, and not the commonwealth.

(c) "It tends to the impoverishment of divers artificers and others,

who, before, by the labor of their hands, in their art or trade, had maintained themselves and their families, who now will of necessity be constrained to live in idleness and beggary."

<sup>3</sup> Justice Field, in his dissenting opinion in the *Slaughter House Cases*, 16 Wall. (U. S.) 104 (1872), said: "The common law of England is the basis of the jurisprudence of the United States. It was brought to this country by the colonists, together with the English statutes, and was established here so far as it was applicable to their condition. The law and the benefit of such of the English statutes as existed at the time of their colonization, and which they had by experience found to be applicable to their circumstances, were claimed by the Congress of the United Colonies in 1774 as a part of their 'indubitable rights and liberties.' Of the statutes, the benefits of which were thus claimed, the statute of James I. against monopolies was one



and a monopoly, in the sense in which the term has been used — if ever granted — would be illegal and void in this country, independent of statutory enactment.

§ 331. **No true Monopolies in United States. Patents and other Quasi-Monopolies.** — A monopoly in its primary sense is, stating essential elements, (a) a grant from the State of (b) an exclusive privilege whereby (c) a class of persons are deprived of privileges previously enjoyed.

There are no monopolies of this character in the United States. Combinations of corporations for the purpose of suppressing competition may possess the last two elements. They may obtain for themselves the absolute control of the market for an article of necessity, and thus restrain others "from that liberty of manufacturing and selling which they had before." Such combinations may be against public policy and illegal, but they are not monopolies, strictly speaking, because the essential element — a legislative grant — is lacking.

Patents, copyrights and grants of exclusive franchises are denominated monopolies, and a patent is sometimes selected  
 .. as an illustration of a true monopoly.<sup>1</sup> They have the first two elements of a monopoly, but not the last. They are legislative grants of exclusive privileges, but they do not

of the most important. And when the Colonies separated from the mother country no privilege was more fully recognized or more completely incorporated into the fundamental law of the country than that every free subject in the British empire was entitled to pursue his happiness by following any of the known established trades and occupations of the country, subject only to such restraint as equally affected all others. The immortal document which proclaimed the independence of the country declared as self-evident truths that the Creator had endowed all men 'with certain inalienable rights, and that among these are life, liberty, and the pursuit of happiness, and that to secure these rights governments are instituted among men.'"

<sup>1</sup> *Edison Electric Light Co. v. Sawyer-Man Electric Co.*, 53 Fed. 598 (1892): "The present complainants are entitled, by the patent laws, to a monopoly, for the term of the patent, of the manufacture and sale of the lamps made under it. The right to this monopoly is the very foundation of the patent system."

Letters patent for new inventions for limited periods were expressly excepted from the operation of the statute against monopolies. 21 James I., ch. 3 (1624).

For consideration of the application of the federal anti-trust statute to combinations in respect of patents and copyrights see *post*, ch. XXXIX.

necessarily encroach upon existing rights. Patents are granted for new inventions, and copyrights for new books. Grants of exclusive franchises for the operation of public utilities not previously existing, do not deprive any class of persons of privileges possessed. Patents, copyrights and exclusive franchises are, however, in the nature of monopolies, and may properly be designated *quasi-monopolies*.<sup>1</sup>

<sup>1</sup> GRANTS OF EXCLUSIVE PRIVILEGES AS CONSTITUTING MONOPOLIES.

The term "monopoly" as applied to grants of exclusive privileges is, in a sense, the antithesis of the term as applied to combinations. A corporation enjoying a grant of exclusive privileges is a monopoly within itself. A number of corporations uniting for the elimination of competition become a monopoly only through the act of combining. The term "monopoly" as applied to the combination — its modern use — relates to intercorporate relations, and combinations amounting to monopolies are considered at length in this treatise. On the other hand, grants of exclusive privileges involve no such relations and their consideration is, strictly speaking, outside the scope of this work. The subject, however, being necessarily opened up, it is thought desirable to extend the examination slightly farther.

As shown in the text monopolies in the original sense were illegal at common law and are unlawful and void in this country without constitutional or statutory enactment. Constitutional provisions have, however, been adopted in a number of States similar to that of Arkansas which provides that, "Perpetuities and monopolies are contrary to the genius of a republic, and shall not be allowed." (See constitutional provisions in ch. XLI., *post*). In construing these provisions as well as in applying the common law with respect to grants of exclusive privileges the term "monopoly" has not been

used in its original sense which, as shown in the text, would have excluded altogether grants of exclusive privileges for the operation of public utilities not previously existing. The broader meaning given to the term in construing such grants is indicated by the following illustrative cases; the majority of which relate to municipal, rather than to legislative, grants:

I

*Cases holding grants of exclusive privileges invalid as creating or tending to create monopolies.*

An ordinance granting an exclusive privilege for the construction of water works and the use of city streets comes within the North Carolina constitutional prohibition against monopolies, notwithstanding such exclusive grant is made as an inducement to the establishment of such works.

*Thrift v. Elizabeth City*, 122 N. C. 31 (1898), (30 S. E. Rep. 349, 44 L. R. A. 427).

A grant by a county of an exclusive right of way to lay piping for supplying a town with water has been held to tend to create a monopoly in violation of the Texas constitutional provision.

*Edwards County v. Jennings*, 89 Tex. 618 (1896), (35 S. W. Rep. 1053). See also *Brenham v. Water Co.* 67 Tex. 542 (1887), (4 S. W. Rep. 143).

An ordinance granting a franchise to an electric light company coupled with a street lighting contract containing a condition that it should not be binding unless the grantee obtained

**§ 332. Modern Use of Term "Monopoly."** — The principal injury to the public resulting from the grant of monopolies

the exclusive right to use the streets for lighting purposes has been held invalid as constituting an attempt to create a monopoly.

*Monroe County Ill. Co. v. Village of Mt. Gilead*, 10 Ohio S. & C. P. Dec. 235 (1900).

A grant of an exclusive privilege to operate gas and electric light plants in a city for a limited time confers a practical monopoly and must be strictly construed against the grantee.

*Capital City Light, etc. Co. v. City of Tallahassee*, 42 Fla. 462 (1900), (28 So. Rep. 810).

An ordinance granting privileges to some persons and refusing them on the same terms to others is void as tending to create a monopoly as well as being oppressive and unreasonable.

*City of Danville v. Noone*, 103 Ill. App. 290 (1902).

A statute authorizing a residence park association to make regulations regarding the pursuits to be carried on in its park does not authorize the creation of a monopoly.

*Thousand Island Park Ass'n v. Tucker*, 173 N. Y. 203 (1903), (65 N. E. Rep. 975).

An ordinance making the use of an article within the control of a single corporation an essential to the performance of a city contract tends to create a monopoly in favor of such corporation and is void.

*Fishburn v. City of Chicago*, 171 Ill. 338 (1898), (49 N. E. Rep. 532; 39 L. R. A. 482). See also *Boon v. City of Utica*, 5 Misc. Rep. 391 (1893), (36 N. Y. Supp. 932). Compare *Field v. Barber Asphalt Co.*, 194 U. S. 618 (1904), (24 Sup. Ct. Rep. 784).

## II

*Cases holding grants of privileges not invalid as creating or tending to create monopolies.*

An ordinance granting to a water company, for a certain period, the privilege of establishing and operating a system of waterworks in a city, but not granting it in terms the exclusive privilege, does not create a monopoly in violation of the Texas constitutional provision.

*Bartholemew v. City of Austin*, 85 Fed. 359 (1898). See also *Waco Water, etc. Co. v. City of Waco*, (Tex. Civ. App. 1894), (27 S. W. Rep. 675).

The grant of an exclusive privilege to a municipality to establish and operate water works does not constitute a monopoly in violation of the Tennessee constitutional provision. An exclusive right in a municipal corporation is distinguished from such a right in a private corporation in that in the one case it is held for the public benefit and in the other for private gain.

*City of Memphis v. Memphis Water Co.*, 5 Heisk (Tenn.) 495 (1871). See also *Brenham v. Water Co.* 67 Tex. 542 (1887), (4 S. W. Rep. 143).

The lease by a city of its gas works coupled with an agreement to do nothing by way of ordinance or otherwise to interfere with the exclusive right of the lessee does not confer a monopoly upon the lessee.

*Bailey v. Philadelphia*, 184 Pa. St. 594 (1898), (39 Atl. Rep. 494).

The grant by harbor commissioners for a term of years of the exclusive use of certain wharves, for the purpose of erecting grain elevators thereon, and providing for equal facilities to the public in the use of such elevators, does not create an unlawful monopoly.

*Taylor v. Montreal Harbor Com-mrs.*, 17 Rep. Jud. Que. C. S. 275 (1899). See also *Northwestern Warehouse Co. v. Oregon R., etc. Co.*, 32

arose from the exercise of the power to control and, consequently, to enhance the prices of commodities of commerce — especially, of the necessities of life. This power, however, may be practically acquired by agreement, as well as by grant. When, by a combination between manufacturers or traders, the control of the market for a commodity is concentrated in the hands of a single company or association of companies, the evils attending the unrestrained control of prices may result.

The possible effect of combinations being, therefore, the same as the effect of the early monopolies, the term “monopoly,” in modern times, is used to describe such combinations, and has acquired a much broader meaning than that originally attaching to it.<sup>1</sup> As so used, it may be broadly defined

Wash. 218 (1903), (73 Pac. Rep. 388).

The legislature has the right to grant exclusive privileges in the charter of a turnpike company and such charter, when accepted by the company, becomes a contract with the State, the obligation of which cannot be impaired.

Nashville etc. Turnpike Co. v. Davidson County, 106 Tenn. 258 (1901), (61 S. W. Rep. 68). See also St. Joseph Plank Road Co. v. Kline, 106 La. Ann. 325 (1901), (30 So. Rep. 854).

The constitution of Alabama provides that the legislature shall pass no act “making any irrevocable grants of special privileges or immunities” and, consequently, the legislature may revoke such grants at its pleasure.

Bienville Water Supply Co. v. City of Mobile, 186 U. S. 212 (1902), (22 Sup. Ct. Rep. 820).

A municipal ordinance giving the exclusive privilege of collecting all refuse within a city to a particular person and prohibiting all other persons from engaging in that business, is not void as creating a monopoly.

State v. Robb, 100 Me. 180 (1905), (60 Atl. Rep. 874).

A statute authorizing a railroad company owning more than three-fourths of the stock of another railroad company to condemn outstanding stock interests does not confer exclusive privileges in violation of the Connecticut constitutional provision that “no man or set of men are entitled to exclusive public emoluments or privileges from the community.”

New York, etc. R. Co. v. Offield, 77 Conn. 417 (1904), (59 Atl. Rep. 510). See *ante*, § 51: “*The Right to condemn Stock.*”

For consideration of other ordinances and municipal contracts held not to grant exclusive privileges tending to create monopolies, see Vincennes v. Gas Light Co., 132 Ind. 114 (1892); (31 N. E. Rep. 573, 16 L. R. A. 485); City of Denver v. Hubbard 17 Colo. App. 346 (1902), (68 Pac. Rep. 993); Reid v. Trowbridge, 78 Miss. 542 (1901), (29 So. Rep. 167).

<sup>1</sup> The meaning now attached to the word “monopoly” is indicated by the following extracts from judicial decisions in different States:

*California.* Herriman v. Menzies, 115 Cal. 16 (1896), (44 Pac. Rep. 660, 56 Am. St. Rep. 82, 35 L. R. A. 319): “A monopoly exists where all, or nearly all, of an article of trade or

as the concentration of business in the hands of a few. In the initial decision in the *Sugar Trust Case*,<sup>1</sup> Judge Barrett said:

commerce within a community or district is brought within the hands of one man or set of men so as to practically bring the handling or production of the commodity or thing within such single control, to the exclusion of competition or free traffic therein. Anything less than this is not monopoly. Webster defines it as the sole power of dealing in any species of goods, and Bouvier as the abuse of free commerce, by which one or more individuals have procured the advantage of selling all of a particular kind of merchandise. And these definitions accord with that given by later writers. Spelling, *Trusts*, § 133. An agreement, the purpose or effect of which is to create a monopoly, is unlawful if it relate to some staple commodity, or thing of general requirement and use or of necessity, and not some thing of mere luxury or convenience."

*Illinois.* *People v. Chicago Gas Trust Co.*, 130 Ill. 294 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497): "Contracts creating monopolies are null and void as being contrary to public policy." (Quoting from 2 Addison on Cont. 743.)

*Craft v. McConoughy*, 79 Ill. 349 (1875), (22 Am. Rep. 171): "In other words, the four firms, by a shrewd, deep laid, secret combination, attempted to control and monopolize the entire grain trade of the town and surrounding country."

*Iowa.* *Chapin v. Brown*, 83 Iowa, 162 (1891), (48 N. W. Rep. 1074, 12 L. R. A. 428): "The agreement is against public policy. It plainly tends to monopolize the butter trade at Storm Lake and destroy competition in that business."

*Michigan.* *Richardson v. Buhl*, 77 Mich. 658 (1889), (43 N. W. Rep.

1102, 6 L. R. A. 457), ("*Diamond Match Case*"): "All combinations among persons or corporations for the purpose of raising or controlling the prices of merchandise, or any of the necessities of life, are monopolies and intolerable, and ought to receive the condemnation of all courts."

*New York.* *Lough v. Outenbridge*, 143 N. Y. 271, 282 (1894), (38 N. E. Rep. 292, 42 Am. St. Rep. 712, 25 L. R. A. 674): "The monopoly which the law views with disfavor is the manipulation of a business in which the public are interested, in such a way as to enable one or a few to regulate it in their own interest, and to the detriment of the public by exacting unreasonable charges."

*De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.*, 16 Daly, 529 (1891), (14 N. Y. Supp. 279): "Neither need the agreement or combination, in order to expose it to the denunciation of the law, constitute a complete monopoly or effect a total suppression of competition."

*Ohio.* *Central Ohio Salt Co. v. Guthrie*, 35 Ohio St. 672 (1880): "The clear tendency of such an agreement is to establish a monopoly, and to destroy competition in trade, and for that reason, on grounds of public policy, courts will not aid in its enforcement."

*Pennsylvania.* *Nester v. Continental Brewing Co.*, 2 Dist. R. 177 (1894): "Where a pool or combination reserves the right to regulate prices, they can, by the manipulation of prices, drive their competitors out of business, create a monopoly, and enhance at their pleasure the prices to consumers."

*Texas.* The constitution of Texas declares: "Perpetuities and monop-

<sup>1</sup> *People v. North River Sugar Ref. Co.*, 54 Hun (N.Y.), 377 (1889), *note*.

"The monopoly with which the law deals is not limited to the strict equivalent of royal grants or people's patents. Any combination, the tendency of which is to prevent competition in its broad and general sense and to control, and thus it will enhance, prices to the detriment of the public, is a monopoly."

olies are contrary to the genius of a free government, and shall never be allowed." Const. 1876, Art. I. § 26. In construing this provision it was said by a federal court (*Laredo v. International Bridge, etc. Co.*, 66 Fed. 246) (1895): "There are classes of exclusive privileges which certainly do not amount to 'monopolies,' within the meaning of the common law or of the Texas constitution. Courts of last resort have generally refrained from propounding an authoritative affirmative definition of the 'monopoly' so odious to the common law and to the genius of a free government. It would try the power of expression of most judges, if not of human speech, to frame such a definition, outside of which a grant or contract must wholly and clearly rest to escape the stroke of nullity."

And in construing the same provision the Texas Court of Civil Appeals in *Jones v. Carter* (Tex. Civ. App. 1907), 101 S. W. Rep. 515, said: "Plaintiff advances the proposition that the term 'monopoly' as used in the constitution of this State means a license or privilege allowed by some sovereign authority for the sale, buying, selling or manufacture of some article or commodity whereby the subjects are restrained of a liberty they therefore had with respect to the matter affected by the franchise. This definition is technically correct. . . But the term as now understood is not confined to the above narrow limits. It embraces any combination or contract, the tendency of which is to prevent competition in its broad and general sense and to

control prices to the detriment of the public, and the form assumed is immaterial."

The Texas anti-trust statute of 1903 contains a definition of the "monopoly" therein prohibited.

*West Virginia. Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1907), (56 S. E. Rep. 269, 116 Am. St. Rep. 901, 10 L. A. R. (N. S.) 268): "Monopoly in its original sense was an exclusive right granted by the State to one or a few which was before of common right. As now used and understood monopoly embraces any combination the tendency of which is to prevent competition in its broad and general sense and to control prices to the detriment of the public."

In this case the Court quoted with approval the following extract from *Pingrey on Industrial and Interstate Contracts* (§ 320): "Monopolies may be divided into three classes: (1) All sources of supply may be put into the hands of one company, so no other source of supply is available. Such a monopoly is absolute and can sell its products at any price limited to the necessities of commerce. (2) The monopoly may have the best and most economical source of supply but competition still be possible, when competition can be suppressed by selling so low by the monopoly that competition is impossible. (3) The monopoly may use its general control of the market to require all parties to buy of it alone, under penalty of being denied further supplies. This method is generally practised by the monopoly."

§ 333. **Direct Test of Validity of Combination not whether it is a Monopoly.** — As already shown, grants of monopolies were invalid at common law even before the enactment of the Statute 21 James I., and — the common law being the basis of American law — such monopolies are illegal and void in the United States.

A modern combination of capital, however, for the purpose of controlling the market for a commodity, is not founded upon legislative concession and does not amount to a monopoly, according to the common law use of that term. It may, however, fall within the broad definition of a monopoly already stated; but in that case the test of its validity is a rule of public policy, rather than common law principles applicable to monopolies of an essentially different nature. Such a combination is invalid, not because it is a monopoly but because it is against public policy. The statement in judicial decisions that “ whatever tends to create a monopoly is unlawful as being contrary to public policy,”<sup>1</sup> merely states an intermediate and unnecessary standard of validity. The essential question is whether a combination — the result of certain agreements and acts — is against public policy; and no useful purpose is served in determining whether it may not also properly be denominated a monopoly, according to the modern use of that term.

In view of the confused state of the law upon the question of the validity of combinations, it is necessary in formulating any rule to reduce the legal principles involved to their simplest and most exact terms, and in so doing the use of the term “ monopoly,” although commonly employed in modern decisions, seems undesirable.

<sup>1</sup> *People v. Chicago Gas Trust Co.*, 497; *Stanton v. Allen*, 5 Denio 130 Ill. 293 (1889), (22 N. E. Rep. 798, (N. Y.), 434 (1848).  
17 Am. St. Rep. 319, 8 L. R. A.

## CHAPTER XXXIII

## APPLICATION OF LAW OF CONTRACTS IN RESTRAINT OF TRADE

§ 334. Definition and Nature of "Contract in Restraint of Trade."

§ 335. Connection between Contracts in Restraint of Trade and Corporate Combinations.

§ 336. Modern Use of Phrase "Contract in Restraint of Trade."

§ 337. Direct Test of Validity of Combination not whether it is in Restraint of Trade.

§ 334. Definition and Nature of "Contract in Restraint of Trade." — The phrase "contract in restraint of trade," according to its primary and historic meaning, may be defined as a contract entered into by a person, — ancillary to a principal contract to which he is a party,<sup>1</sup> — wherein he binds himself, for a consideration, not to engage in a particular trade, business or occupation, for a stated term, within a prescribed territory.<sup>2</sup>

Contracts of this nature are usually entered into by vendors upon the sale of a business, property or practice, with the good-will attaching thereto, and are necessary in order to make the transfer of the good-will effective. They may, however, when conformable to governing principles, lawfully be entered into as ancillary to various other contracts.

In *United States v. Addyston Pipe, etc. Co.*<sup>3</sup> Judge Taft, speaking for the Circuit Court of Appeals, said: "Covenants in partial restraint of trade are generally upheld as valid when they are agreements (1) by the seller of property or business, not to compete with the buyer in such a way as to derogate

<sup>1</sup> *Chappell v. Brockway*, 21 Wend. (N. Y.) 162 (1839): "A man cannot for money alone, where he has no other interest in the matter, purchase a valid contract in restraint of trade, however limited may be the circle of its operation."

See also *Fox, etc. Steel Co. v. Schoen*, 77 Fed. 29 (1896); *United States v. Addyston Pipe, etc. Co.*, 85 Fed. 271 (1898), (46 L. R. A. 122).

<sup>2</sup> "Strictly speaking, a contract in restraint of trade is any contract whereby any party binds himself not to follow some particular occupation, trade, calling or profession, or engage in some particular business or enterprise for a period within a particular territory." 2 Eddy on Combinations, § 688.

<sup>3</sup> *United States v. Addyston Pipe, etc. Co.*, 85 Fed. 281 (1898), (46 L. R. A. 122).



from the value of the property or business sold; (2) by a retiring partner not to compete with the firm; (3) by a partner, pending the partnership, not to do anything to interfere, by competition or otherwise, with the business of the firm; (4) by the buyer of property not to use the same in connection with the business retained by the seller; and (5) by an assistant, servant, or agent not to compete with his master or employer after the expiration of his time of service."

§ 335. **Connection between Contracts in Restraint of Trade and Corporate Combinations.** — Contracts in restraint of trade, as defined in the preceding section, have but an incidental connection with combinations of corporations. A vendor corporation, and the persons interested in it, as ancillary to the contract of sale, might agree with the purchasing corporation, in the formation of a corporate combination, not to engage in the same business again. Such an agreement, if within the limitations applicable to such contracts, would be, strictly, a contract in restraint of trade. But the principal contract between the corporations — even though designed to suppress competition — could only be referred to as a contract in restraint of trade by ignoring the meaning originally attaching to that phrase.

While conventional contracts in restraint of trade are only of adventitious interest in considering the legal principles governing combinations of corporations, it may be noted that the law concerning such contracts, as laid down by the courts, has undergone a process of relaxation — from strict disapproval to liberal enforcement. As said by Lord Macnaghten in the leading case of *Nordenfelt v. Maxim-Nordenfelt Co.*:<sup>1</sup> "In the age of Queen Elizabeth, all restraints of trade, whatever they were, general or partial, were thought to be contrary to public policy, and therefore void."<sup>2</sup> In time, however, it was found that a rule so rigid and far-reaching must seriously interfere with transactions of every-day occurrence. Traders could hardly venture to let their shops out of their own hands; the purchaser

<sup>1</sup> *Nordenfelt v. Maxim-Nordenfelt Co.*, App. Cas. (1894), 564 (63 L. J. Ch. 923). See also *Wright v. Rider*, 36 Cal. 342 (1868), (95 Am. Dec. 186).

<sup>2</sup> Citing *Colgate v. Bacher*, 1 Croke, 872 (1602).

of a business was at the mercy of the seller; every apprentice was a possible rival. So the rule was relaxed. It was relaxed as far as the exigencies of trade for the time being required, gradually and not without difficulty, until it came to be recognized that all partial restraints might be good, though it was thought that general restraints, that is, restraints of general application extending throughout the kingdom, must be bad."

There has never been a departure from the principle that contracts restraining a person from engaging in *any* business or occupation are absolutely void. In other directions, however, the early rule has been modified, and the courts have uniformly enforced contracts in partial restraint of trade, limited as to duration and the territory embraced, and have stated various arbitrary rules for determining what limitations of time and place are required by considerations of public policy.<sup>1</sup> While the American courts have not followed the most

<sup>1</sup> The development of the law concerning contracts in restraint of trade, in their primary sense, is illustrated in the following list of early and recent cases, selected with reference to such contracts in restraint of trade as might naturally be incidental to the transfer of a business in the formation of a corporate combination:

*United States: Navigation Co. v. Winsor*, 20 Wall. 64 (1873); *Fowle v. Parke*, 131 U. S. 88 (1889), (9 Sup. Ct. Rep. 658); *Chicago, etc. R. Co. v. Pullman Southern Car Co.*, 139 U. S. 79 (1891), (11 Sup. Ct. Rep. 490); *United States v. Addyston Pipe, etc. Co.*, 85 Fed. 271 (1898), *affirmed* 175 U. S. 211 (1899), (20 Sup. Ct. Rep. 96); *United States Chemical Co. v. Provident Chemical Co.*, 64 Fed. 946 (1894); *Harrison v. Glucose Sugar Refining Co.*, 116 Fed. 304 (1902), (58 L. R. A. 915); *National Enameling, etc. Co. v. Haberman*, 120 Fed. 415 (1903).

An agreement by a patentee in connection with the sale of a patent that he will not, during the life of the patent, become connected with any corporation manufacturing articles

similar to those covered by the patent is not a contract in restraint of trade and competition and is valid.

*American Brake Beam Co. v. Pungs*, 141 Fed. 923 (1905).

*California: Wright v. Rider*, 36 Cal. 342 (1868), (95 Am. Dec. 186); *Callahan v. Donnolly*, 45 Cal. 152 (1872), (13 Am. Dec. 172).

*Indiana: Beard v. Dennis*, 6 Ind. 200 (1855), (63 Am. Dec. 380); *Eisel v. Hayes*, 141 Ind. 41 (1895), (40 N. E. Rep. 119).

*Maine: Whitney v. Slayton*, 40 Me. 224 (1855).

*Massachusetts: Pierce v. Fuller*, 8 Mass. 223 (1811), (5 Am. Dec. 102); *Alger v. Thacher*, 19 Pick. 51 (1837), (31 Am. Dec. 119); *Taylor v. Blanchard*, 13 Allen, 370 (1866); *Game-well Fire Alarm Tel. Co. v. Crane*, 160 Mass. 50 (1893), (35 N. E. Rep. 98, 39 Am. St. Rep. 458, 22 L. R. A. 673); *Anchor, etc. Mfg. Co. v. Hawkes*, 171 Mass. 101 (1898), (50 N. E. Rep. 509, 68 Am. St. Rep. 403, 41 L. R. A. 189).

*Michigan: Hubbard v. Miller*, 27 Mich. 15 (1873), (15 Am. Dec. 153); *Beal v. Chase*, 31 Mich. 490 (1875).

recent English decisions<sup>1</sup> in holding that a contract in restraint of trade may, under certain circumstances, be enforced, although unlimited both in regard to time and territory, there is a tendency both in England and America, in determining the validity of such a contract, to apply the reasonable test stated by Lord Chief Justice Tindall in *Horner v. Graves*:<sup>2</sup> "We do not see how a better test can be applied to the question, whether reasonable or not, than by considering whether the restraint is such only as to afford a fair protection to the interests of the party in favour of whom it is given, and not so large as to interfere with the interests of the public. Whatever restraint is larger than the necessary protection of the party, can be of no benefit to either, it can only be oppressive; and if oppressive, it is, in the eye of the law, unreasonable."

§ 336. **Modern Use of Phrase "Contract in Restraint of Trade."** — The phrase "contract in restraint of trade," in the absence of an acquired meaning, would have a broad application. "Competition is the life of trade," and any contract having for its object the restriction of competition might appropriately be described as a contract in restraint of trade.<sup>3</sup>

*New Jersey*: *Trenton Potteries Co. v. Olyphant*, 58 N. J. Eq. 507 (1899), (43 Atl. Rep. 723, 78 Am. St. Rep. 612, 46 L. R. A. 255).

*New York*: *Lawrence v. Kidder*, 10 Barb. 641 (1851); *Diamond Match Co. v. Roeber*, 106 N. Y. 473 (1887), (60 Am. Rep. 464, 13 N. E. Rep. 419); *Tode v. Gross*, 127 N. Y. 480 (1891), (28 N. E. Rep. 469, 24 Am. St. Rep. 475, 13 L. R. A. 652); *Leslie v. Lorillard*, 110 N. Y. 519 (1888), (18 N. E. Rep. 363, 1 L. R. A. 456); *Wood v. Whitehead Bros. Co.*, 165 N. Y. 545 (1901), (59 N. E. Rep. 357); *Brett v. Ebel*, 29 App. Div. 256 (1898), (51 N. Y. Supp. 573).

*Ohio*: *Lange v. Werk*, 2 Ohio St. 519 (1853).

*Wisconsin*: *Berlin Machine Works v. Perry*, 71 Wis. 495 (1888), (38 N. W. Rep. 82, 5 Am. St. Rep. 236).

*England*: *Mitchel v. Reynolds*, 1 P. Wms. 181 (1711), (*Smith's Lead-*

*ing Cases*, 7 Eng. Ed. 407, 8 Am. Ed. 756); *Ward v. Byrne*, 5 M. & W. 548 (1839); *Whittaker v. Howe*, 3 Beav. 383 (1841); *Jones v. Lees*, 1 H. & N. 189 (1856); *Leather Cloth Co. v. Lorsche*, L. R. 9 Eq. 345 (1869); *Rousillon v. Rousillon*, L. R. 14 Ch. Div. 351; *Nordenfelt v. Maxim-Nordenfelt Co.*, App. Cas. (1894) 535 (63 L. J. Ch. 908).

<sup>1</sup> *Nordenfelt v. Maxim-Nordenfelt Co.*, App. Cas. (1894) 535 (63 L. J. Ch. 908); *Badische Anilin und Soda Fabrik v. Schott*, 61 L. J. Ch. 698 (1892); *Underwood v. Barker*, 1 Ch. 300 (1899), (68 L. J. Ch. 201).

<sup>2</sup> *Horner v. Graves*, 7 Bing. 743 (1831).

<sup>3</sup> *Ferd. Heim Brewing Co. v. Belinder*, 97 Mo. App. 64 (1903), (71 S. W. Rep. 691): "'Competition' is the struggle between rivals for the same trade at the same time. It is self-evident that there can not be

In this sense, the phrase is used in many modern statutes and judicial decisions.<sup>1</sup>

competition unless there is trade, and so, though the popular saying is that 'competition is the life of trade,' yet it is quite certain that trade is the mother of competition, for the latter springs from the former, so, therefore, whatever restrains trade restrains competition in exact degree."

<sup>1</sup> In *Anderson v. Shawnee Compress Co.*, 17 Akl. 231 (1906), (87 Pac. Rep. 315) (*affirmed sub nom.* *Shawnee Compress Co. v. Anderson* by the U. S. Supreme Court, April 13, 1908) the Court said: "The public welfare is the first consideration to which the courts will look, and then the question of whether the restraint upon the one party is or is not greater than the protection of the other requires. It is now the general holding that when one engaged in any business or occupation sells out his stock in trade and good-will, he may make a valid contract with the purchaser binding himself not to engage in the same business in the same place for a time named, and this is about as far as contracts in restraint of trade have been upheld by the courts in this country or in England. But when, by the principal operation of any contract, it encroaches upon the rights of the public and transgresses the liberty of free competition, consideration then for the public welfare and for society becomes paramount, and must predominate over any individual right to contract. It is immaterial in determining the legality of such contracts whether or not it was entered into with any evil intent, but the material consideration is its injurious tendency, and the power thereby given to control prices. Nor, in order to vitiate a contract, is it essential that its result should be a complete monopoly. It is sufficient if it really tends to that end, and to

deprive the public of the advantages derived from free competition."

In *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 244 (1899), (20 Sup. Ct. Rep. 96), Mr. Justice Peckham said: "We have no doubt that where the direct and immediate effect of a contract or combination among particular dealers in a commodity is to destroy competition between them and others, so that the parties to the contract or combination may obtain increased prices for themselves, such contract or combination amounts to a restraint of trade in the commodity, even though contracts to buy such commodity at the enhanced price are continually being made."

In *Nester v. Continental Brewing Co.*, 161 Pa. St. 481 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894), the Supreme Court of Pennsylvania said of an agreement among brewers to regulate the price of beer: "The test question, in every case like the present, is whether or not a contract in restraint of trade exists which is injurious to the public interests. If injurious, it is void as against public policy."

*State v. Smiley*, 65 Kan. 240, 257 (1902), (69 Pac. Rep. 199, 67 L. R. A. 903), *affirmed* 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289): "From very early times it was the policy of the common law to encourage competitive trade, and to discourage contract restraints upon it. The courts refused to enforce stipulations between parties looking to the imposition of such restraints. The rule of policy remains to this day, and to this day the courts continue their refusal to countenance contracts of the character mentioned. . . . A great array of decisions, English and American, will be found

Such use of the phrase should be condemned. The phrase has acquired a well-defined meaning. As already shown, for three hundred years it has been applied to ancillary contracts to refrain from engaging in a particular business, and other contracts of that nature; and there is no apparent reason why confusion should be occasioned by its use, at the present time, to describe contracts of an essentially different nature, however appropriate in the choice of words such use may be. But the more serious objection to the modern use of the phrase is that it offers a false standard for determining

. . . all tending to the establishment of the proposition that combinations having for their object the restraint of trade by the prevention of competition are inimical to public policy, their contracts in furtherance of their object non-enforceable, and their agreements of confederacy, followed by acts in prosecution of their purpose, rightful subjects of restrictive and penal legislation."

*American Biscuit, etc. Co. v. Klotz*, 44 Fed. 725 (1891): "So far, therefore, as the complainant's business is a combination in restraint of trade, . . . the law stamps it as unlawful, and the courts should not encourage it."

*John D. Park & Sons Co. v. Nat. Wholesale Druggists Ass'n*, 50 N. Y. Supp. 1665 (1896): "It is in restraint of trade and unlawful for such manufacturer to become a party to a combination which shall prevent any of his customers from obtaining other goods of other manufacturers," etc.

*India Bagging Ass'n v. Kock*, 14 La. Ann. 164 (1849): "The agreement between the parties [not to sell cotton bagging except under certain conditions] was palpably and unequivocally a combination in restraint of trade, and to enhance in the market an article of ordinary necessity to cotton planters."

*Distilling, etc. Co. v. People*, 156 Ill. 486 (1895), (41 N. E. Rep. 188):

"No one . . . can . . . doubt that it was designed to be, and was in fact, a combination in restraint of trade, and that it was organized for the purpose of getting control of the manufacture and sale of all distillery products, so as to stifle competition." See also *State v. Nebraska Distilling Co.*, 29 Neb. 700 (1890), (46 N. W. Rep. 155).

*Klingel's Pharmacy v. Sharp*, 104 Md. 230 (1906), (64 Atl. Rep. 1029): "Where the direct and immediate effects of a contract or combination among particular dealers in a commodity is to destroy competition between them and others, so that the parties to the contract or combination may obtain increased prices for themselves, such contract or combination amounts to a restraint in trade of the commodity, even though contracts to buy such commodity at the enhanced price are constantly being made. Total suppression of trade in the commodity is not necessary in order to make the contract one in restraint of trade."

The federal anti-trust statute also uses the phrase "contract in restraint of trade" in the broad sense and its meaning is more fully examined in connection with the construction of that statute. See *post*, § 387, "*Use of Phrase 'Contract in Restraint of Trade.'*"

the validity of industrial combinations. The validity of a combination for the suppression of competition depends upon rules of public policy relating to the control of markets. The well established principles governing conventional contracts in restraint of trade, although likewise founded upon considerations of public policy, have little application. And yet, an examination of reported cases will show that the courts, in determining the validity of such combinations, repeatedly refer to those principles, and, in some cases, that contracts manifestly against such rules of public policy have been declared lawful because limitations in regard to time and space were reasonable.<sup>1</sup>

§ 337. **Direct Test of Validity of Combination not whether it is in Restraint of Trade.** — Even if the modern use of the phrase "contract in restraint of trade" were unobjectionable, it is unnecessary.

<sup>1</sup> "The utter inadequacy of the doctrine condemning contracts in restraint of trade, as a basis to which to refer that against restrictions upon competition seems to us to be made clear by illustration. At least until very recently, the doctrine against contracts in restraint of trade would have been so applied as to hold illegal the withdrawal (without limit as to time or space) of one out of a thousand trade competitors in a given city, notwithstanding that the continuance of the other nine hundred and ninety-nine would have effectually prevented the danger of a monopoly. On the other hand, the same doctrine would (as modified as to space) have been ordinarily so applied as to hold legal the withdrawal, by agreement, of the nine hundred and ninety-nine, though such withdrawal would seem to be ordinarily within the condemnation of the present doctrine against restriction upon competition." Article in 33 Am. Law Rev. 68, entitled "Anti-Trust Legislation and the Doctrine against Contracts in Restraint of Trade." See also note to

Harding v. American Glucose Co., 74 Am. St. Rep. 235.

Pocahontas Coke Co. v. Powhatan Coal, etc. Co., 60 W. Va. 508 (1907), (56 S. E. Rep. 271, 116 Am. St. Rep. 901, 10 L. R. A. (N.S.) 268): "Many of the late authorities draw a distinction between contracts which were in 'restraint of trade' as that phrase was understood in the early history of the common law, and contracts which are in 'restraint of competition' and which are also in restraint of trade as understood in modern times. Both classes of contracts when unreasonable and to the injury of the public are alike illegal and against public policy. The illegality of a contract or combination for the restraint of competition does not lie in the agreement not to compete but in its reflex injury to the public. One way to control prices is to destroy or restrain competition. It has been said that many of the cases decided in America holding contracts valid as not being in unreasonable restraint of trade would have been held otherwise if the modern doctrine as to restraint of competition had been properly applied."

Contracts and combinations in restraint of trade are declared to be contrary to public policy and, therefore, invalid. But the test of the validity of a combination, as pointed out in reference to monopolies,<sup>1</sup> is whether the particular acts and agreements of the parties in forming it are of such a nature, and for such a purpose, as to be against public policy. If so, the combination is invalid; and, if not against public policy, it is immaterial whether it is in restraint of trade.

The syllogism: All contracts in restraint of trade are against public policy; this combination is a contract in restraint of trade; therefore, it is against public policy, formulates the reasoning in many decisions. This reasoning, while logical, is circuitous. The essential question is whether the combination, itself, is opposed to public policy. The determination of this question is not promoted by the intervention of another standard.

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## CHAPTER XXXIV

### FORMULATION OF RULES OF PUBLIC POLICY

- § 338. Definition and Nature of Public Policy.
- § 339. Necessity for Rules of Public Policy.
- § 340. Difficulty of formulating Rules of Public Policy concerning Combinations.
- § 341. Formulation of Rules. Basis in Judicial Decisions.
- § 342. Basis of Rules — (A) Case of the Sugar Trust.
- § 343. Basis of Rules — (B) Case of the Standard Oil Trust.
- § 344. Basis of Rules — (C) Whiskey Trust Cases.
- § 345. Basis of Rules — (D) Case of the Preservers Trust.
- § 346. Basis of Rules — (E) Case of the Chicago Gas Trust.
- § 347. Basis of Rules — (F) Case of the Diamond Match Company.
- § 348. Basis of Rules — (G) Case of the Glucose Combination.
- § 348a. Basis of Rules — (H) Case of the Pocahontas Coke Company.
- § 349. Basis of Rules — (I) Miscellaneous Cases.

§ 338. **Definition and Nature of Public Policy.** — “Public policy,” said Lord Brougham, “is that principle of the law

<sup>1</sup> *Ante*, § 333: “*Direct Test of Validity of Combination not whether it is a Monopoly.*”

which holds that no subject can lawfully do that which has a tendency to be injurious to the public, or against the public good."<sup>1</sup> A more precise definition cannot well be stated. Although the fundamental principles are unchangeable,<sup>2</sup> public policy, in its very nature, is uncertain and fluctuating.<sup>3</sup> It varies with the times.<sup>4</sup> The growth of trade and commerce

<sup>1</sup> *Egerton v. Brownlow*, 4 H. L. Cas. 196 (1853). See also *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497).

<sup>2</sup> *Brooks v. Cooper*, 50 N. J. Eq. 769 (1893), (26 Atl. Rep. 981, 35 Am. St. Rep. 793, 21 L. R. A. 617), *per* Lippincott, J. "It has been declared that public policy is a variable quality, but the principles to be applied have always remained unchanged and unchangeable, and public policy is only variable in so far as the habits, capacities and opportunities of the public have become more varied and complex. The relations of society become from time to time more complex; statutes defining and declaring public and private rights multiply rapidly, and public policy often changes as the laws change, and therefore new applications of old principles are required. Whatever tends to injustice and oppression, restraint of liberty, restraint of legal right; whatever tends to the obstruction of justice, a violation of a statute, or the obstruction or perversion of the administration of the law; whatever tends to interfere with or control the administration of the law, as to executive, legislative or other official action, whenever embodied in and made the subject of a contract, the contract is against public policy, and therefore void, and not susceptible of enforcement. All contracts prejudicial to the interests of the public, such as contracts tending to prevent competition, whenever the statute or any known rule of law require it, are void."

<sup>3</sup> In *Richardson v. Mellish*, 2 Bing. 252 (1824), Mr. Justice Burrough said: "I, for one, protest, as my Lord has done, against arguing too strongly upon public policy; it is a very unruly horse, and when once you get astride it you never know where it will carry you."

<sup>4</sup> In *Koehler v. Feurbach*, 2 Mo. App. 14 (1876), the Court said: "What constitutes public policy is not, perhaps, exactly determinable; it is indefinite in its nature, changing with the habits, wants, and opinions of society. Fore-stalling, regrating, and engrossing were prohibited by statute in England three hundred years ago, and were considered to be against public policy so late as the time of Blackstone. They are now the great basis of profits; are not only practised every day, but are recognized as the very life of trade, and without them it may be said that commerce, as known amongst us, would be at an end. . . . Contracts in total restraint of trade, or of marriage, against the prohibitions of statutes, to infringe a copyright, to defraud the government or third parties, to oppress third parties or prevent the due course of justice, or induce a violation of public duty, that tend to encourage unlawful or immoral acts, or that are founded on trading with an enemy, are all against public policy, and void. And, probably, this is a complete enumeration of the several classes to which contracts against public policy may be reduced."



has made acts and contracts which formerly were in conflict with public policy, recognized and approved methods of doing business. It is as impossible to give an exact definition of the phrase as it is to define fraud. The rule stated by Judge Story,<sup>1</sup> however, may safely be applied: "*Whenever any contract conflicts with the morals of the time, and contravenes an established interest of society, it is void, as being against public policy.*"

The public policy of a State is manifested, primarily, by its statutes and, secondarily, by its judicial decisions.<sup>2</sup> Questions of public policy, however, generally arise in connection with contracts which are neither *mala prohibita* nor *mala in se*. The former are expressly prohibited and the latter are manifestly unlawful. In testing the validity of this middle class of contracts by the standard of public policy, the right of the individual to contract — a fundamental right — is liable to be impaired, and such contracts should be set aside only when clearly inimical to established interests of society.<sup>3</sup>

§ 339. **Necessity for Rules of Public Policy.** — As already shown, the application of the law of monopolies and of con-

<sup>1</sup> 1 Story on Contracts, 649.

<sup>2</sup> United States v. Trans-Missouri Freight Ass'n, 166 U. S. 340 (1897), (17 Sup. Ct. Rep. 559): "The public policy of the government is to be found in its statutes, and when they have not directly spoken, then in the decisions of the courts and the constant practice of the government officials; but when the law-making power speaks upon a particular subject, over which it has constitutional power to legislate, public policy in such a case is what the statute enacts. If the law prohibit any contract or combination in restraint of trade or commerce, a contract or combination made in violation of such law is void, whatever may have been theretofore decided by the courts to have been the public policy of the country on that subject."

See also *Harding v. American Glucose Co.*, 182 Ill. 551 (1899), (55 N. E.

Rep. 577, 74 Am. St. Rep. 235, 64 L. R. A. 738).

<sup>3</sup> *Kellogg v. Larkin*, 3 Pin. (Wis.) 136 (1851), (56 Am. Dec. 164): "I by no means intend to deny the right or propriety of judicially determining that a contract that is actually at war with any established interest of society is void, however individuals may suffer thereby, because the interest of individuals must be subservient to the public welfare. But I insist that before a court should determine a contract which has been made in good faith, stipulating for nothing that is *malum in se*, nothing that is made *malum prohibitum*, to be void as contravening the policy of the State, it should be satisfied that the advantage to accrue to the public from so holding is certain and substantial, not theoretical or problematical."

tracts in restraint of trade in determining the validity of a particular combination, only leads to the result that if it is against public policy, it is illegal.

The same consequence follows the application of other tests which have been stated by the courts and text writers. Thus, it has been said that the test of the illegality of a combination is the injury to the public. It is undoubtedly true that the law condemns only those combinations which are injurious to the public, but, as an effective test of the validity of a combination, the statement is valueless. In applying it, the only result obtainable is that if a particular combination injures the public it is illegal; but the essential question, whether it is injurious, can only be determined by the application of a rule of public policy. So, in a more definite form, it is stated that a combination of competing producers is illegal which has for its object the maintenance of prices and restriction of production. But agreements to maintain prices and limit production are only means of restraining competition, and power to control prices and restrict production is only an incident of the suppression of competition. To what extent combinations in restraint of competition are invalid depends upon the application of a rule of public policy.

The formulation of rules of public policy is, therefore, necessary in order to obtain definite standards for determining the legality or illegality of any combination.

§ 340. **Difficulty of formulating Rules of Public Policy concerning Combinations.** — When public policy is manifested by statute, the statute is itself the rule;<sup>1</sup> when it is manifested by judicial decisions, based upon a uniform course of reasoning, the formulation of a rule of public policy requires only the classification of governing principles. But whatever rules of public policy may exist for determining the validity of a combination of corporations have been evolved coincidentally with the development of the combination itself, and the process of evolution has been circuitous. The courses of reasoning by which different courts have arrived at the same

<sup>1</sup> When a combination is authorized or prohibited by statute, that fact is conclusive upon the question of public

policy. *Stewart v. Erie, etc.* Transp. Co., 17 Minn. 372 (1871).

conclusion have varied widely; and, upon the same state of facts, different conclusions have been reached.

The formulation of rules from conflicting decisions upon a subject uncertain in its nature is, obviously, attended with difficulties.

§ 341. **Formulation of Rules. Basis in Judicial Decisions.** — While the framing of rules of public policy concerning combinations is difficult, both by reason of the subject and conflicting decisions, certain broad principles may be gathered from the current of authority. Combinations of a certain nature are clearly against public policy and void. Other combinations are clearly valid. Concerning still others, there is an irreconcilable diversity of judicial opinion.

In ascertaining these principles, an extended examination of the decisions of the courts is necessary. Judicial decisions form the basis of any rule of public policy not established by statute, and leading cases must be carefully examined to ascertain their underlying principles. In presenting the result of such an examination in a treatise, general propositions may be misleading. The law, in cases of combinations, is closely interwoven with the facts. An exact appreciation of the principles of public policy enunciated can only be obtained by examining the reasons and reasoning of the court, in connection with the facts of the case. It, therefore, seems advisable to state the conclusions of the courts — extracts from the opinions — in the leading cases upon combinations of corporations, together with facts sufficient to indicate the scope of the decisions — as indicating the *basis* of rules of public policy.<sup>1</sup>

§ 342. **Basis of Rules — (A) Case of the Sugar Trust.** — The two leading cases upon the validity of combinations are, un-

<sup>1</sup> It can hardly be said that the formulation of rules of public policy is so necessary now as it was before the adoption of the federal, and the many State, anti-trust statutes. These statutes manifestly furnish the most effective tests of the validity of combinations, and the recent cases upon the subject of combinations have nearly all been brought under such statutes. In fact, the cases examined

in the following pages, from which the rules of public policy are formulated, appeared, with few exceptions, in the first edition of this treatise. Rules of public policy are, however, necessary in States having no anti-trust statutes. And even in the States having such statutes, they are, as a general rule, held to supplement and add to, but not to supersede, common law remedies.

doubtedly, the cases of the Sugar and Standard Oil Trusts.

In the *Sugar Trust Case*,<sup>1</sup> the trial court, Judge Barrett, said: "Any combination, the tendency of which is to prevent competition in its broad and general sense, and to control, and thus at will enhance, prices to the detriment of the public,

<sup>1</sup> *People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33), s. c. 54 Hun, 354 (1889), (3 N. Y. Supp. 401). (The latter report includes both the general and special term decisions.)

The Sugar Trust was a combination of sugar refineries, formed in 1887, under the name of the Sugar Refineries Company. Individuals and firms took the form of corporations before entering the combination. All the stock of the several corporations was transferred to a board of eleven trustees, who issued in lieu thereof "trust certificates" for corresponding proportionate amounts. The object of the "trust," as stated in the agreement, was as follows:

"(1) To promote economy of administration and reduce the cost of refining, thus enabling the price of sugar to be kept as low as is consistent with reasonable profit.

"(2) To give to each refinery the benefit of all appliances, known or used by the others, and useful to improve the quality and diminish the cost of refined sugar.

"(3) To furnish protection against unlawful combinations of labor.

"(4) To protect against inducements to lower the standard of refined sugars.

"(5) Generally to promote the interests of the parties hereto in all lawful and suitable ways."

The trustees received the profits from all the plants and distributed them as dividends upon the "trust certificates." Directors of the several corporations were chosen, but had

no power. *Quo warranto* proceedings were instituted by the attorney-general of New York against the North River Sugar Refining Company, a constituent corporation, upon the ground that it was a party to an unlawful combination, and, also, had exceeded its chartered powers. The case was first heard before Judge Barrett, at special term, who held that the combination was a monopoly, and that the defendant corporation had forfeited its charter by *ultra vires* acts injurious to the public. Upon appeal to the general term, the former decision was sustained upon similar grounds. The Court of Appeals, while affirming the judgment, placed its decision solely upon the ground that the corporation had forfeited its charter by entering into an unlawful partnership of corporations, and by attempting to practically consolidate with other corporations without following the consolidation statute.

The decision in this case was, however, without practical effect. The trust was reorganized under the laws of New Jersey in the form of a corporate combination, and has done business ever since.

For other cases relating to the Sugar Trust, see *People v. American Sugar Ref'g Co.* (Cal.), 7 Ry. & Corp. L. J. 83 (1890); *Cameron v. Havemeyer*, 25 Abb. N. C. 438 (1890), (12 N. Y. Supp. 126); *Gray v. De Castro*, etc. *Sugar Ref'g Co.*, 57 Hun (N. Y.), 592 (1890), (10 N. Y. Supp. 632); *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249).

is a legal monopoly. And this rule is applicable to every monopoly, whether the supply be restricted by nature or susceptible of indefinite production. The difficulty of affecting the unlawful purpose may be greater in one case than in the other, but it is never impossible. Nor need it be permanent or complete. It is enough that it may be even temporarily and partially successful."

Upon appeal, the general term, Judge Daniels, said: "In this case it was a leading object to combine together the different corporations and individuals engaged in this business, not only in and about the City of New York, but throughout the country, and to secure that control by a substantial organization for an indefinite period of time. This was not to be done, and was not, in fact, done for an idle purpose, or merely to furnish the means of protection against unlawful combinations or for any mere economical object, but it was, manifestly, to place this business within the control, and subject to the dictation, of this association, and of the board selected for the government of its affairs. And, after putting forth the efforts necessary to secure the end, it would not only be idle, but absurd, to indulge in the supposition that it was not intended to wield the authority, in this manner secured, for the pecuniary advantage of the associates. And the direct and usual way in which that is accomplished, following out the common impulses of practical business men, is by the advancement of the prices of the commodities manufactured and sold, in the course of the business whose control may be in this way secured. When the opportunity to do that is provided, human selfishness is sure to turn it to a profitable account. A jury certainly would be fully justified in concluding, from the agreement and the other facts in evidence in the case, that the governing object of the association was to promote its interests and advance the prosperity of the associates, by limiting the supply, when that could properly be done, and advancing the prices of the products produced by the companies. To conclude otherwise would be to violate all the observations and experiences of practical life. This is a controlling feature in this controversy. And that it was intended to be secured by the organization provided for, and which actually took place, is reasonably free

from doubt. And where that appears to be the fact, the agreement, association, combination or arrangement, or whatever else it may be called, having for its objects the removal of competition and the advancement of prices of necessities of life, is subject to the condemnation of the law, by which it is denounced as a criminal enterprise."

The Court of Appeals, however, finally decided the case upon grounds peculiar to corporation law, saying: "We have reached our conclusion, and it appears to us to have been established that the defendant corporation has violated its charter and failed in the performance of its corporate duties, and that in respects so material and important as to justify a judgment of dissolution. Having reached that result, it becomes needless to advance into the wider discussion over monopolies and competition and restraint of trade and the problems of political economy. Our duty is to leave them until some proper emergency compels their consideration."

§ 343. **Basis of Rules — (B) Case of the Standard Oil Trust.** — In the *Case of the Standard Oil Trust*<sup>1</sup> the Supreme Court of Ohio, by Judge Minshall, said:

<sup>1</sup> *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 379, 34 Am. St. Rep. 541, 15 L. R. A. 145, 36 Am. & Eng. Corp. Cas. 1).

The celebrated Standard Oil Trust, a combination of corporations engaged in the production and sale of petroleum and its products, was formed in 1882 by a trust agreement, substantially in the following form:

(1) "As soon as practicable, a corporation shall be formed in each of the following States under the laws thereof, to wit: Ohio, New York, Pennsylvania and New Jersey. . . ."

(2) "The purpose and powers of said corporation shall be to mine for, produce, manufacture, refine, and deal in petroleum and all its products, and all the materials used in such businesses, and transact other business collateral thereto. . . ."

(3) "At any time hereafter, . . . similar corporations may be formed in other States and Territories."

(4) "Each of said corporations shall be known as the Standard Oil Co. of [name of State]."

(5) "The capital stock of each of said corporations shall be fixed at such an amount as may seem necessary. . . ."

(6) "The shares of stock of each corporation shall be issued only for money, property, or assets, equal at a fair valuation to the par value of the stock delivered therefor."

(7) "All of the property, real and personal, assets and business of each and all of the corporations . . . mentioned in class first . . . in or of each particular State, shall be transferred to and vested in the Standard Oil Company of that particular State. . . ."

(8) "The individuals embraced in class second . . . agree . . . to sell, assign, transfer, convey and set over all the property, real and personal, assets and business mentioned and

"By this agreement, indirectly it is true, but none the less effectually, the defendant is controlled and managed by the Standard Oil Trust, an association with its principal place of business in New York City, and organized for a purpose contrary to the policy of our laws. Its object was to establish a virtual monopoly of the business of producing petroleum, and of manufacturing, refining and dealing in it and all its products, throughout the entire country, and by which it might not merely

embraced in schedules accompanying such sale and transfer to the Standard Oil Company, or Companies, of the proper State or States. . . "

(9) "The parties embraced in class third . . . agree to assign and transfer all the stock held by them in the corporations . . . herein named to the trustees herein provided for. . . And whenever and as often as all the stocks of any corporation . . . are vested in said trustees, the proper steps may then be taken to have all the money, property, real and personal, of such corporation . . . conveyed to the Standard Oil Company of the proper State, . . . in which event the trustees shall receive stocks of the Standard Oil Companies equal to the value of the money, property, and business assigned. . . "

(10) "The consideration for the transfer . . . to each or any of the Standard Oil Companies, shall be the stock of the respective . . . company to which such transfer or conveyance is made. . . . Said stock shall be delivered to the trustees. . . ."

(11) "The consideration for any stocks delivered to said trustees . . . shall be the delivery . . . to the persons entitled thereto of trust certificates . . . equal at par value to the par value of the stock of the said Standard Oil Companies so received by said trustees."

This agreement was signed by all the officers and stockholders of the Standard Oil Co. of Ohio,—the

defendant in the case, — but its corporate name and seal were not affixed.

*Quo warranto* proceedings were instituted by the attorney-general of Ohio upon the ground that the defendant corporation had misused its franchises by becoming a party to an agreement opposed to public policy.

The Supreme Court of Ohio held upon demurrer to the defendant's answer:

1. That the defendant company entered into the agreement in its corporate capacity.

2. That the agreement subjected the defendant to a control inconsistent with its character as a corporation.

3. That it provided for an association contrary to public policy.

Judgment of absolute ouster was denied on account of the statute of limitations, but it was decreed that the defendant be ousted "from the power to make and perform" said agreement.

This judgment was rendered in 1892, and at the present time (1908) the same combination — perhaps in a different form — is carrying on a business of far-reaching and ever-increasing magnitude.

For consideration of rights of holders of Standard Oil "trust certificates," see *Rice v. Rockefeller*, 134 N. Y. 174 (1892), (31 N. E. Rep. 907, 30 Am. St. Rep. 658, 17 L. R. A. 237).

control the production, but the price, at its pleasure. All such associations are contrary to the policy of our State and void. . . . Much has been said in favor of the objects of the Standard Oil Trust, and what it has accomplished. It may be true that it has improved the quality and cheapened the cost of petroleum and its products to the consumer. But such is not one of the usual or the general results of a monopoly; and it is the policy of the law to regard, not what may, but what usually happens. Experience shows that it is not wise to trust human cupidity when it has the opportunity to aggrandize itself at the expense of others. . . .

"A society in which a few men are the employers, and the great body are merely the employees or servants, is not the most desirable in a republic; and it should be as much the policy of the laws to multiply the numbers engaged in independent pursuits or in the profits of production, as to cheapen the price to the consumer. Such policy would tend to an equality of fortunes among its citizens, thought to be so desirable in a republic, and lessen the amount of pauperism and crime."

§ 344. **Basis of Rules — (C) Whiskey Trust Cases.** — In the *Case of the Distillers and Cattle Feeders Trust*<sup>1</sup> ("Whiskey

<sup>1</sup> *State v. Nebraska Distilling Co.*, 29 Neb. 700 (1890), (46 N. W. Rep. 155). The Distillers and Cattle Feeders Trust, an unincorporated association, was formed in 1887 by the owners of nine distilleries located north and west of the Ohio River, for the purpose of restricting the output, regulating prices, and suppressing competition in the manufacture and sale of alcohol, high wines, and other liquors. The object of the trust was accomplished by its getting control of as many distilleries as possible, and the method adopted is stated in the report as follows: "An arrangement or agreement is made by which the company is to transfer its capital stock to the trustees of the Distillers and Cattle Feeders Trust, for which said trustees are to issue certificates of the trust. The real estate upon which the dis-

tillery plant is situated is deeded to some one member of the company as trustee for the stockholders, and the trustee then leases said real estate to the company for the term of twenty-five years. The capital stock of the company is cancelled and new stock issued to said nine trustees of the trust, for which the trustees give the agreed amount of certificates of the trust. The board of directors of the company resigns and a new board is elected, a majority of which are taken from the nine trustees of the trust. . . . The trustees of the trust have almost unlimited power and control over all distilleries that enter it. They can limit their production or suspend their operation altogether. . . . The trustees confine the production of the distilleries under their control to the large houses situated in favorable localities, which



Trust"), the Supreme Court of Nebraska said: "The findings in this case, to which no objection is made, clearly show that the object of the Distilling Company in entering into the illegal combination was to destroy competition and create a monopoly, not only by limiting the production of alcohol, but, by dismantling as many distilleries as the trust saw fit, absolutely prevent the manufacture of the article except in the few establishments controlled by the trust, and thus it would be enabled to control prices, prevent production, and create a monopoly of the most offensive character."

In a later case against the Distilling and Cattle Feeding Company,<sup>1</sup> successor to the Distillers and Cattle Feeders Trust, the Supreme Court of Illinois said, concerning the latter combination: "There can be no doubt, we think, that the Distillers and Cattle Feeders Trust, which preceded the

can be run at less expense than small houses located in unfavorable places.

. . . The said trustees can, and do, at will restrict and limit the production and supply of alcohol, spirits, and other liquors, and thereby enhance their value."

The Nebraska Distilling Company became a party to the trust in the manner described. *Quo warranto* proceedings were instituted against that corporation, and, upon the facts stated, the Supreme Court of Nebraska held that the trust agreement was contrary to public policy and void, and that the defendant corporation had forfeited its charter.

The Distillers and Cattle Feeders Trust being thus attacked, a corporation, called the Distilling and Cattle Feeding Company, was formed, in 1890, for the purpose of taking over the assets of the trust and it issued its certificates of stock in lieu of the old trust certificates.

*Quo warranto* proceedings against the new corporation were instituted by the attorney-general of Illinois upon the ground that it was a mere continuation, in corporate form, of an illegal trust, and the Supreme

Court of Illinois, in *Distilling and Cattle Feeding Co. v. People*, 156 Ill. 448 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200), held that the conveyance from the trust to the corporation was merely a form; that (p. 491) "the trust, . . . being repugnant to public policy and illegal it is impossible to see why the same is not true of the corporation which succeeds to it and takes its place."

Judgment of ouster was thereupon pronounced against the company.

Prior to final decree, however, a receiver of the corporation had been appointed by the United States Circuit Court (Olmstead *v. Distilling and Cattle Feeding Co.*, 73 Fed. 44 (1895)), and the property of the corporation was subsequently sold, and, through a reorganization plan, another corporation, The American Spirits Manufacturing Company, organized under the laws of New Jersey, acquired the assets and business. Various reorganizations have taken place since that time.

<sup>1</sup> *Distilling and Cattle Feeding Co. v. People*, 156 Ill. 486 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200).

incorporation of the defendant, was an organization which contravened well-established principles of public policy, and that it was, therefore, illegal. No one who intelligently considers the scheme of this trust, as detailed in the information, can for a moment doubt that it was designed to be, and was, in fact, a combination in restraint of trade, and that it was organized for the purpose of getting control of the manufacture and sale of all distillery products, so as to stifle competition, and to be able to dictate the amount to be manufactured and the prices at which the same should be sold, and thus to create, or tend to create, a virtual monopoly of the manufacture and sale of products of that character."

§ 345. Basis of Rules — (D) Case of the Preservers Trust. — In *Bishop v. American Preservers Co.*<sup>1</sup> the Supreme Court of

<sup>1</sup> *Bishop v. American Preservers Co.*, 157 Ill. 311 (1895), (41 N. E. Rep. 765, 48 Am. St. Rep. 317), *per* McGruder, J.

The American Preservers Trust was a voluntary association formed, originally, by the stockholders of seven corporations located in different States, and engaged in the business of preserving fruit. The trust agreement provided for the creation of a board of nine trustees, to whom the parties agreed to transfer their stock in exchange for trust certificates. The trustees were to hold in trust the stocks transferred to them, receive the dividends thereon, and distribute the same in the form of dividends upon the certificates. The trustees were also authorized to purchase the stock, or the plants and property, of other corporations by the issue of trust certificates. They were also empowered to organize other corporations, to carry on the business of the trust, and to acquire and hold the stock of such corporations. The trust was to continue twenty-five years, unless sooner terminated by the act of a certain number, in excess of a majority, of the certificate holders.

In accordance with the provisions of the trust agreement, the trustees formed a corporation called the American Preservers Company. This company instituted an action of replevin against one Bishop to recover possession of certain property which he had agreed to transfer to the corporation, and of which he had given a bill of sale and for which trust certificates had been issued to him. Bishop had previously tendered his certificates back, retained possession of the property, and defended the suit upon the ground that the corporation was merely an instrument of an unlawful trust and without standing in court to enforce the agreement. The Supreme Court of Illinois held that the trust agreement was an illegal contract and refused to grant relief, saying (p. 316): "The law will not aid the appellee to recover the property, but will leave both it and the appellant where they were when the suit was begun."

In *American Preservers Trust v. Taylor Mfg. Co.*, 46 Fed. 152 (1891), this trust was also held to be invalid upon principles of corporation law. Judge Thayer said: "The question now before the court is, whether a

Illinois said: "The agreement recites that it is designed by its signers to form a trust for the purpose of securing coöperation in the business of manufacturing preserves, etc., and of selling and dealing in the same in home and foreign markets. This coöperation, to be secured through the extraordinary powers conferred upon the nine trustees named in the agreement, six of whom are designated by name and authorized to elect three others, could not result otherwise than in a grinding monopoly, controlling all trade in the business specified, and raising or depressing prices therein at the will of the trustees. . . . It will thus be seen that the agreement in question makes provision for welding together all the interests engaged in the business named in the agreement, into one giant combination or partnership under the absolute dominion and control of a board of nine trustees. Its illegal purpose is apparent upon its face, and, therefore, under the decisions above referred to, it must be held to be void, as being injurious to the public interest."

§ 346. **Basis of Rules — (E) Case of the Chicago Gas Trust.** — In *People v. Chicago Gas Trust Co.*<sup>1</sup> the Supreme Court of Illinois said:

business corporation, organized under the laws of this State, has the right to become a member of such an association with such extensive power, and that inquiry must be answered in the negative."

<sup>1</sup> *People v. Chicago Gas Trust Co.*, 130 Ill. 294 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497). The Chicago Gas Trust Company was organized in 1887, under the general incorporation act of Illinois, for two purposes, as stated in its articles of incorporation: *First*, to erect and operate gas works for the manufacture and sale of gas in the City of Chicago, and other places in Illinois. *Second*, to purchase, hold and sell the capital stock, or purchase or lease the property, plants, good-will, rights and franchises of other gas companies in Chicago or elsewhere in Illinois.

The corporation did not erect or

operate any gas works, but sought to exercise the power claimed under the second clause and acquired a majority of the capital stock of four independent gas companies then doing business in Chicago, thereby controlling them.

*Quo warranto* proceedings against the Trust Company were instituted by the attorney-general of Illinois upon the ground that it had usurped and exercised "powers, liberties, privileges and franchises not conferred by law." The defendant pleaded that it acted within the powers conferred by its charter.

A demurrer to the plea was overruled by the lower court, but sustained by the Supreme Court of Illinois upon the following grounds: (1) That the corporation had no express power to hold the stock of other corporations. (2) That it did not

“ Public policy is that principle of the law which holds that no subject or citizen can lawfully do that which has a tendency to be injurious to the public or against the public good. This principle owes its existence to the very sources from which the common law is supplied.<sup>1</sup> The common law will not permit individuals to oblige themselves by a contract either to do or not to do anything when the thing to be done or omitted is in any degree clearly injurious to the public. . . . ‘ Contracts creating monopolies are null and void as being contrary to public policy.’<sup>2</sup> All grants creating monopolies are made void by the common law.<sup>3</sup> In the *Case of the Monopolies*<sup>4</sup> it was decided as long ago as the forty-fourth year of the reign of Queen Elizabeth, that a ‘ grant to the plaintiff of the sole making of cards within the realm was utterly void, and that for two reasons: 1. That it is a monopoly and against the common law. 2. That it is against divers acts of parliament.’ . . . Of what avail is it that any number of gas companies may be formed under the general incorporation law, if a giant trust company can be chartered with the power of buying up and holding the stock and property of such companies, and, through the control thereby attained, can direct all their operations and weld them into one huge combination? The several privileges or franchises intended to be exercised by a number of companies are thus vested exclusively in a single corporation. To create one corporation for the express purpose of enabling it to control all the corporations engaged in a certain kind of business, and particularly a business of a public character, is not only opposed to the public policy of the State, but is in contravention of the spirit, if not the letter, of the constitution. That the exercise of the power attempted to be conferred upon the appellee company must result in the creation of a monopoly, results from the very nature of the power itself.”

acquire such power by claiming it in its articles of association; (3) That it had no such incidental power; (4) That its exercise of such power was unlawful; (5) That the stock of the four companies was acquired by the Trust Company with the design of bringing them “under its control, and by crushing out competition to

monopolize the gas business of Chicago.”

<sup>1</sup> Citing *Greenhood on Public Policy*, pp. 2, 3.

<sup>2</sup> Citing 2 *Addison on Contracts*, 743.

<sup>3</sup> Citing 7 *Bacon's Abridgment*, 22.

<sup>4</sup> Citing *Case of the Monopolies*, Part 11, *Coke*, 86 b (1602).

§ 347. **Basis of Rules — (F) Case of the Diamond Match Company.** — In *Richardson v. Buhl* ("Diamond Match Company Case"),<sup>1</sup> the Supreme Court of Michigan (*per* Judge Sherwood) said: "The organization is a manufacturing company. The business in which it is engaged is making friction matches. Its articles provide for the aggregation of an enormous amount of capital, sufficient to buy up and absorb all of that kind of business done in the United States and Canada, to prevent any other person or corporation from engaging in or carrying on the same, thereby preventing all competition in the sale of

<sup>1</sup> *Richardson v. Buhl*, 77 Mich. 657 (1889), (43 N. W. Rep. 1102, 6 L. R. A. 457).

The following facts were stated in the opinions: "It appeared from the testimony that the Diamond Match Company was organized for the purpose of controlling the manufacture and trade in matches in the United States and Canada. The object was to get all the manufacturers of matches in the United States to enter into a combination and agreement, by which the manufacture and output of all the match factories should be controlled by the Diamond Match Company. Those manufacturers who would not enter into the scheme were to be brought out, those who proposed to enter into the business were to be bought off, and a strict watch was to be exercised to discover any person who proposed to engage in such business, that he might be prevented, if possible. All who entered into the combination, and all who were bought off, were required to enter into bonds to the Diamond Match Company that they would not, directly or indirectly, engage in the manufacture or sale of friction matches, nor aid nor assist, nor encourage any one else in said business, where, by doing so, it might conflict with the business interests, or diminish the sales, or lessen the profits, of the Diamond Match Company. These restrictions

varied in individual cases, as to the time it was to continue, from ten to twenty years. Thirty-one manufacturers, being, substantially, all the factories where matches were made in the United States, either went into the combination or were purchased by the Diamond Match Company, and out of this number all were closed except thirteen."

An action involving the construction of a contract entered into in connection with the formation of the combination came before the Supreme Court of Michigan. No questions as to the validity of the contract or combination upon grounds of public policy, or otherwise, were raised by the parties; but the Court, of its own volition, held both the combination and the contract unlawful and refused to grant relief, saying: "A court of equity will leave the parties . . . where it finds them, outside the rules of courts of justice, '*in pari delicto*,' and they must settle their own grievances and unlawful transactions."

Compare, however, *Diamond Match Co. v. Roeber*, 106 N. Y. 473 (1887), (13 N. E. Rep. 419, 60 Am. Rep. 464), where the New York Court of Appeals enforced one of the bonds above referred to without raising any question as to the validity of the combination.

the article manufactured. This is the mode of conducting the business and the manner of carrying it on. The sole object of the corporation is to make money, by having it in its power to raise the price of the article, or diminish the quantity to be made and used, at its pleasure. Thus, both the supply of the article and the price thereof are made to depend upon the action of a half-dozen individuals, more or less, to satisfy their cupidity and avarice, who may happen to have the controlling interest in this corporation, an artificial person, governed by a single motive or purpose, which is to accumulate money regardless of the wants or necessities of over sixty million of people. The article thus completely under their control, for the last fifty years has come to be regarded as one of necessity, not only in every household in the land, but one of daily use by almost every individual in the country. It is difficult to conceive of a monopoly which can affect a greater number of people, or one more extensive in its effect on the country, than that of the Diamond Match Company. It was to aid that company in its purposes, in carrying out its object, that the contract in this case was made between these parties, and which we are now asked to aid in enforcing. Monopoly in trade or in any kind of business in this country is odious to our form of government. It is sometimes permitted to aid the government in carrying on a great public enterprise, or public work under government control, in the interest of the public. Its tendency is, however, destructive of free institutions, and repugnant to the instincts of a free people, and contrary to the whole scope and spirit of the federal Constitution, and is not allowed to exist under express provision in several of our State constitutions. Indeed, it is doubtful if free government can long exist in a country where such enormous amounts of money are allowed to be accumulated in the vaults of corporations, to be used at discretion in controlling the property and business of the country against the interest of the public and that of the people, for the personal gain and aggrandizement of a few individuals. It is always destructive of individual rights, and of that free competition which is the life of business, and it revives and perpetuates one of the great evils which it was the object of the framers of our form of government to eradicate and prevent.

It is alike destructive to both individual enterprise and individual prosperity, whether conferred upon corporations or individuals, and therefore public policy is, and ought to be, as well as public sentiment, against it. All combinations among persons or corporations for the purpose of raising or controlling the prices of merchandise, or any of the necessities of life, are monopolies, and intolerable; and ought to receive the condemnation of all courts."

Judge Champlin said in concurring: "Such a vast combination as has been entered into under the above name is a menace to the public. Its object and direct tendency is to prevent free and fair competition, and control prices throughout the national domain. It is no answer to say that this monopoly has, in fact, reduced the price of friction matches. That policy may have been necessary to crush competition. The fact exists that it rests in the discretion of this company at any time to raise the price to an exorbitant degree. Such combinations have frequently been condemned by the courts as unlawful and against public policy."

§ 348. **Basis of Rules — (G) Case of the Glucose Combination.**

— In the case of *Harding v. American Glucose Company*,<sup>1</sup>

<sup>1</sup> *Harding v. American Glucose Co.*, 182 Ill. 615 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738). The following is a brief summary of the facts in this important case: Prior to 1897, seven competing corporations alone were engaged in the manufacture of glucose — a corn product — in the corn belt of the United States, which is the only territory in which it can be successfully manufactured. In that year, a scheme was entered into for the purpose of combining the properties of these corporations in a single corporation, and all of said companies, except one — the smallest — became parties to such arrangement. Accordingly, the Glucose Sugar Refining Company was organized under the laws of New Jersey for the purpose of acquiring the plants of the several companies. Option contracts were signed by each

company wherein it agreed to sell all its real and personal property, good-will, trademarks, etc., to a trust company or its transferee, if requested within a reasonable time. These contracts provided that payment for the properties transferred should be in stock of the new company, or, sometimes, partly in cash and partly in stock. The options were exercised, and the plants and other property of the companies were transferred or about to be transferred to the new corporation.

Thereupon a stockholder of one of said companies — the American Glucose Company, a New Jersey corporation — who objected to the transfer, filed a bill for an injunction to restrain the transfer of the property of his corporation to the combination upon the ground that the whole arrangement was for the purpose of control-

the Supreme Court of Illinois reaffirmed its earlier decisions that trusts and combinations, for the prevention of competition, are against public policy: "Any combination of competing corporations for the purpose of controlling prices, or limiting production, or suppressing competition, is contrary to public policy, and is void. . . . In the present case each of six corporations, engaged in the manufacture of glucose, made a contract to sell its plant to a new corporation to be organized, and agreed not to engage in such manufacture for a term of years, and then conveyed all its property to the new corporation organized to conduct the same kind of business; and it did all this with the knowledge and understanding that each of five other competing corporations was making the same kind of contract, and executing the same kind of conveyance in respect to their own respective properties, all to be consummated and delivered at the same time, and under the direction and management of agents or promoters employed by all the corporations. If the transactions referred to in the bill in this case did not amount to an absolute agreement made in advance between the six corporations, they at least constituted a scheme understood by all the corporations, and participated in by them all. The carrying out of the scheme, thus understood and participated in, would necessarily result in the suppression of competition in the manufacture of glucose, and in the creation of a monopoly in that business. . . . The material consideration in the case of such combinations is, as a general thing, not that prices are raised, but that it rests in the power and discretion of the trust or corporation, taking all the plants of the several corporations, to raise prices at any time, if it sees fit to do so. It does not relieve the trust of its objectionable features that it may reduce the price of the articles which it manufactures, because such reduction may be brought about for the express purpose of crushing out some competitor or competitors."

ling prices, suppressing competition, and creating a monopoly.

The Supreme Court of Illinois, for the reasons stated in the text, and others, sustained the claim of the complainant, and granted the relief prayed for.

The case is also of importance in determining the rights and *status* of corporations and their stockholders — parties to unlawful combinations — in foreign States, with reference to property there situated.



§ 348a. **Basis of Rules — (H) Case of the Pocahontas Coke Company.** — In the very recent case of *Pocahontas Coke Co. v. Powhatan Coal and Coke Co.*<sup>1</sup> the Supreme Court of West Virginia said: "We now come to a consideration of the contract upon the principles of the common law. For the purpose of determining whether or not the contract is illegal under the rules of the common law, we consider, not only the

<sup>1</sup> *Pocahontas Coke Co. v. Powhatan Coal and Coke Co.* 60 W. Va. 508 (1906), (56 S. E. Rep. 264 116 Am. St. Rep. 901, 10 L. R. A. (n. s.) 268). In this case several producers and manufacturers of coke, among whom was the appellant in said action — the Powhatan Company — entered into a contract agreeing to form a corporation for the stated purpose of regulating, improving and standardizing the quality of coke manufactured by them and providing that upon the formation of such corporation, each producer or manufacturer should enter into a three years' contract for the sale by such corporation of all coke produced by it upon a stipulated commission, and that provision should be made for a penalty or liquidated damages in case such producer should sell its coke through any other agency, or to any person other than such corporation. When the corporation — the Pocahontas Company — was organized (it being the appellee in said action) the parties to the above contract entered into a "uniform contract" whereby the appellee was appointed their sole sales agent. The following year the appellee received notice from the appellant whereby the latter undertook to terminate its contract with it, and gave notice that it would no longer deliver coke to the appellee. The appellee then brought a suit in which an injunction was awarded restraining the appellant from selling, through any agent or agencies other than appellee, or in any other way, any of the coke cov-

ered by the terms of such contract and from refusing to carry out the contract by withdrawing its coke from the appellee as its sole agent, until the further order of the court. The appellant then moved to dissolve the injunction, which motion was denied by a judge in vacation, from which the appellant appealed.

The appellant sought to have said contract set aside on the ground that it was in restraint of trade and tended to monopoly and was against public policy. Under this ground it contended (1) that the contract was illegal under the federal anti-trust law; (2) that the contract was illegal under the rules of the common law.

It was held that, upon the facts before the court, it did not appear that the contract contemplated interstate or international commerce in the coke which constituted the subject-matter of the contract — that the contract was capable of being fully performed within a State and, therefore, was not illegal under the federal act.

But it was further held that the combination established by the contract was in unreasonable restraint of trade and against public policy; that when all the powers conferred by the contract were exercised, the direct and necessary or natural effect was to restrain competition and control prices, and that such effect was not merely incidental, commensurate, or necessary to the protection of the parties in the enjoyment of the legitimate fruits of a lawful undertaking.

contract, but its subject-matter, the situation of the parties, and all the circumstances surrounding the transaction, so far as they are disclosed by the allegations of the bill.

“Coke, the subject-matter of the contract, is a legitimate article of trade and commerce, a commodity of extensive use. Under the recent decisions, it is immaterial whether it is an article of prime necessity or not. If a contract concerning an article of prime necessity would be illegal as in unreasonable restraint of trade, it is likewise illegal if its subject-matter be any other article of legitimate trade or commerce. If the question were material, we would have little difficulty in arriving at the conclusion that coke, like coal, is properly classified under the head of necessities.

“Twenty separate and independent coke manufacturing and producing corporations, operating in the same coal field, entered into contract A, and afterwards each entered into contract B. Do these contracts, under the circumstances appearing, effectuate and consummate an arrangement, combination, or trust in unreasonable restraint of trade, tending to monopoly, and against public policy, under the common law? If so, every contract whereby such combination or trust was effectuated and established is void and unenforceable between the parties, and the courts will refuse to assist them in enforcing its performance. We approach the determination of this question, realizing the great change that has taken place in industrial conditions and in business methods from those prevailing in the early history of the common law, and that courts are constantly called upon to apply the principles of that law to such new conditions, in view of many decisions, diverse and oftentimes conflicting, and amid an evolution of the application of old principles, rather than the announcement of new principles, and to reach conclusions guided by what they deem the best considered cases and authorities on the subject.

“Monopoly, in its original sense, was an exclusive right granted by the State to one or a few of something which was before of common right. As now used and understood, monopoly embraces any combination the tendency of which is to prevent competition in its broad and general sense, and to control prices to the detriment of the public. A trust has been

defined as a contract, combination, confederation, or understanding, express or implied, between two or more persons, to control the price of a commodity or services for the benefit of the parties thereto, and to the injury of the public, and which tends to create a monopoly.

\*       \*       \*       \*       \*       \*

“ It may be said in this connection that the determination of the question whether or not a contract is in restraint of trade is to be arrived at in exactly the same way and under exactly the same rules, whether the case falls under the provisions of the act of Congress or under the rules of the common law. The difference between the act and the common law does not lie in the manner of ascertaining whether or not restraint exists, but in the degree of restraint required to render the contract illegal. Under the act of Congress any restraint is illegal, while under the common law only unreasonable restraint is illegal.

\*       \*       \*       \*       \*       \*

“ It is deducible from the authorities that, if the direct and necessary or natural effect of a contract or combination among producers and sellers of a commodity is to restrain competition and control prices, to the injury of the public, when all the powers of the contract or combination shall have been exercised, the contract or combination is in unreasonable restraint of trade and against public policy. . . .

“ It is no defence to the illegality of a contract or combination which is in unreasonable restraint of trade to show that in the particular case a complete monopoly has not been formed, or that no control of prices has been exercised, or that prices have been lowered and not raised. If a contract or combination in unreasonable restraint of trade could not be attacked until a complete monopoly had been formed, then the law against monopolies would be unavailing. In this country it would be almost impossible to combine all the interests in any line of industry into a single and complete monopoly. If only complete monopolies could be reached under the law, a combination could then be formed tending to monopoly and embracing substantially all the evil results of a complete monopoly, intentionally leaving out of the combination some one or more of those

engaged in the industry, for the very purpose of rendering the combination legal.

“A contract which is charged to be in restraint of trade is not to be tested by what has been done under it, but by what may be done under it; not by its performance, but by its powers of performance when fully exercised. Many of the later authorities draw a distinction between contracts which were in ‘restraint of trade,’ as that phrase was understood in the early history of the common law, and contracts which are in ‘restraint of competition,’ and which are also in restraint of trade, as understood in modern times. Both classes of contracts, when unreasonable and to the injury of the public, are alike illegal and against public policy. The illegality of a contract or combination for the restraint of competition does not lie in the agreement not to compete, but in its reflex injury to the public. One way to control prices is to destroy or restrain competition. It has been said that many of the cases decided in America, holding contracts valid as not being in unreasonable restraint of trade, would have been held otherwise if the modern doctrine as to restraint of competition had been properly applied.

“In passing upon a contract claimed to be in restraint of trade, whether the parties agree to refrain from trade or from competition, the courts have endeavored to concede the greatest liberty of contract consistent with the public good. Yet the constitutional liberty of contract has never been held to give parties the right to contract contrary to public policy and to have that contract respected by the courts.

\* \* \* \* \*

“Conceding, for the sake of argument, that the purpose stated is lawful, we are not limited, in ascertaining the real purpose of the contract, to a consideration of the purpose stated. If all that was necessary, in order to render legal a contract otherwise illegal because in unreasonable restraint of trade, were to state in the contract a legal main purpose, such statement would furnish an easy evasion of the law.

\* \* \* \* \*

“We are clearly of the opinion that it was not necessary, in order to arrange for the improvement of conditions in the manufacture, inspection, and shipment of coke, and in order

to regulate and improve the quality of coke, manufactured by said corporation or in said field, for the said corporations to form a trust or combination, the direct effect of which is to destroy all competition among them, to pool their combined production and cause them to enter the market for the sale of the production of all as a single concern, and which tends to restrain competition between them and others engaged in the same business."

§ 349. **Basis of Rules — (I) Miscellaneous Cases. —**

*I. American Biscuit Combination.* In *American Biscuit, etc. Co. v. Klotz*<sup>1</sup> the Court said: "We are not satisfied that the complainant's business is legitimate. While the nominal purpose of the complainant corporation, as stated in its charter, is the manufacture and sale of biscuit and confectionery, its real scope and purpose seem to be to combine and pool the large competing bakeries throughout the country into practically what is known and called a 'trust,' the effect of which is to partially, if not wholly, prevent competition, and enhance prices of necessary articles of food, and secure, if not a monopoly, a large control of the supply and prices in leading articles of breadstuffs."

*II. National Lead Trust.* In *National Lead Co. v. Grote Paint Store Co.*,<sup>2</sup> the Court of Appeals in Missouri said: "That

<sup>1</sup> *American Biscuit, etc. Co. v. Klotz*, 44 Fed. 723 (1891). The American Biscuit and Manufacturing Company was formed for the nominal purpose of manufacturing and selling biscuit and confectionery. In its actual operation it had acquired, at the time of this decision, control of thirty-five of the leading bakeries in twelve different States of the West and South. The stock of the company was parcelled out in payment for the plants acquired "on an agreed value of the property and a large estimate of good-will. Each bakery when secured to be carried on by its former managers, subject, however, as to control of funds, territory, prices, and competition to the central management; all profits pooled, and of course, division thereof to be made

on the basis of the stock assigned to each bakery" (p. 724).

Klotz & Co. sold their biscuit and confectionery business to the combination for stock at an agreed valuation. One Klotz, of the firm of Klotz & Co., continued to manage the business as agent for the company for some time, when he repudiated the transfer and resumed possession of the property in behalf of Klotz & Co. The American Biscuit and Manufacturing Company then brought suit for an injunction, accounting and receiver. The Court declined to appoint a receiver in interlocutory proceedings for the reasons stated in the text.

<sup>2</sup> *National Lead Co. v. Grote Paint Store Co.*, 80 Mo. App. 266 (1899).

The question involved in this case

the predecessor of the plaintiff, the 'National Lead Trust,' was an unlawful combination, both in purpose and fact, is sufficiently established by the nature of the agreement under which it was created and the methods and practices resorted to in furtherance of that agreement. The agreement can only be construed as a contract to suppress competition, fix the price of commodities and limit their production, and to restrain trade. Unless some one or all of these purposes had been entertained by the signers of the trust agreement, it would not have contained provisions looking to the acquisition by the trustees of the entire lead business of the country, nor would it have united, in the accomplishment of that end, a majority of the stockholders of the largest corporations dealing in that product. . . . While the conclusion of the illegal purpose of the trust agreement is irresistible upon a consideration of its several provisions and the manner in which they were carried out, it will appear from an examination of the cases that this result has been declared by every court called upon to review that agreement, or others substantially like it."

*III. Cases of Associations.* Of an association of manufacturers for the purpose of regulating the price of wire cloth, a New York court<sup>1</sup> said: "The people have a right to the necessities and conveniences of life at a price determined by the relation of supply and demand, and the law forbids any agreement or combination whereby that price is removed beyond the salutary influence of legitimate competition."

Of an association for the purpose of controlling the manufacture and sale of salt, the Supreme Court of Ohio<sup>2</sup> said: "Public policy, unquestionably, favors competition in trade, to the end that its commodities may be afforded to the consumer as cheaply as possible, and is opposed to monopolies, which tend to advance market prices to the injury of the general public."

was whether the plaintiff corporation, successor to the "Trust," was a party to an illegal combination in violation of the Missouri anti-trust act. See *post*, ch. XLII.: "*Construction and Application of State Anti-trust Statutes.*"

<sup>1</sup> *De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.*, 16 Daly (N. Y.), 529 (1891), (14 N. Y. Supp. 278).

<sup>2</sup> *Central Ohio Salt Co. v. Guthrie*, 35 Ohio St. 672 (1880).

And in the leading case of *Morris Run Coal Co. v. Barclay Coal Co.*,<sup>1</sup> already referred to at length, the Court said of an association of five coal companies: "This combination has a power in its confederated form which no individual action can confer. The public interest must succumb to it, for it has left no competition free to correct its baleful influence."

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## CHAPTER XXXV

### RULES OF PUBLIC POLICY

§ 350. In General.

§ 351. Distinction between Rules of Public Policy applicable to Private and *Quasi*-public Corporations.

§ 352. Rules.

§ 353. Rules Conservative Standards.

§ 354. Analysis of Rule governing Private Corporations — (A) Form of Combination Immaterial.

§ 355. Analysis of Rule — (B) Objects and Tendencies of Combinations.

§ 356. Analysis of Rule — (C) Control of the Market.

§ 357. Analysis of Rule — (D) Extent of Territory.

§ 358. Analysis of Rule — (E) Useful Commodities.

§ 359. Analysis of Rule applicable to *Quasi*-public Corporations.

§ 350. In General. — In formulating the rules of public policy stated in this chapter from the decisions of the courts which form their bases, the cases have been examined with a view of ascertaining and harmonizing, so far as possible, their underlying principles. No attempt has been made to follow the language, or to use the particular expressions employed in the opinions. Thus, the phrase "control of the market," in the rule governing private corporations, appears in few cases, but it is made use of because it appears to embody, in a concise expression, the conception of the courts in the phrases "destruction of competition," "establishment of a virtual monopoly," "control of supply and prices," "control of all trade in the business" and others of a similar nature. So the

<sup>1</sup> *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173, 186 (1871), 8 Am. Rep. 159. See *ante*, § 328, *note*.

phrase "useful commodity," in the rule, has seldom been employed by the courts, but it includes "the necessities of life" mentioned in many cases, and places only a slight — though necessary — limitation upon the "commodities of commerce" referred to in others.

§ 351. **Distinction between Rules of Public Policy applicable to Private and Quasi-public Corporations.** — A rule of public policy governing industrial combinations applies alike to private corporations and individuals. The right of trading and producing companies to combine is not affected by their corporate character, except so far as principles of corporation law are involved. In framing a rule for determining the validity of such combinations, regard must be had, on the one hand, to the right to contract, and, on the other, to the effect of the exercise of the right upon the public welfare.

*Quasi-public corporations*, in consideration of the grant of special privileges and franchises, assume the performance of public duties. In formulating a rule of public policy respecting such corporations, it is of primary importance to regard the corporation as a party to a contract with the State, and to consider the effect of a combination upon its ability to perform, in a manner most beneficial to the public, the obligations it has assumed.

The State has an indirect interest in combinations of private corporations to see that nothing is done prejudicial to the public welfare. It has a direct contractual interest to see that the grantee of public franchises properly fulfils its covenants.

§ 352. **Rules.** — (1) *Any combination of corporations or individuals the object of which is, or the necessary or natural consequence of the operation of which will be, the control of the market for a useful commodity, is against public policy and unlawful.*

(2) *Any combination of quasi-public corporations the object of which is, or the necessary or natural consequence of the operation of which will be, the increase of charges beyond reasonable rates, or the curtailment of facilities afforded the public, is against public policy and unlawful.*

§ 353. **Rules Conservative Standards.** — The rules state conservative standards. That relating to private corporations



furnishes rather a test of illegality than of legality. There are, undoubtedly, combinations contrary to public policy, which do not contravene its provisions, but, on the other hand, it is believed that every combination which does come within its provisions is against public policy and invalid. Combinations for the restriction of competition, not amounting to a control of the market, have, in many cases, been declared invalid. But conflicting decisions are equally numerous, and the line between lawful and unlawful restriction is not readily drawn. Unlawful combinations may be in such form that it is impossible to say that their object is to control the market for a commodity, but these are exceptions and will often be found to be within the rule applicable to *quasi*-public corporations.

The latter rule was more readily formulated and is more easily applied. The nature of the *quasi*-public corporation enters into the rule. Any combination which interferes with the performance, in the most advantageous manner, of its obligations to the State is against public policy.

§ 354. **Analysis of Rule governing Private Corporations** — (A) **Form of Combination Immaterial.** — The test of the legality of a combination lies in its object and not in its form. The view that a combination by means of a purchasing corporation is less vulnerable than other forms of combination is well founded only with reference to questions of corporation law.

An association of corporations may be *ultra vires* of its members; a trust contravenes elementary legal principles; a corporate combination, *per contra*, may be formed through the exercise of the ordinary corporate powers of purchase and sale. But the same principles of public policy are applicable. That which public policy forbids in the case of an association or trust cannot lawfully be done by a corporate combination, and *vice versa*.<sup>1</sup>

<sup>1</sup> *Harding v. American Glucose Co.*, 182 Ill. 615 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 235, 64 L. R. A. 738): "A trust has usually appeared in the form of an agreement between stockholders in many corporations to place all their stock in the hands

of trustees, and to receive trust certificates therefor from the trustees. But the question in the present case is whether a trust is created where a majority of stockholders consolidate their interests by conveying all their property to a corporation, organized

A distinction has been drawn between contracts of independent manufacturers, for the purpose of restricting competition, and the purchase by one corporation, under the power contained in its charter, of the properties and business of competing corporations, which may have the effect of suppressing competition. The suppression of competition, in the former case, is said to be opposed to public policy ; while, in the latter case, it is declared to be only the necessary result of the exercise of an express statutory power. Thus, in *Trenton Potteries Co. v. Olyphant*,<sup>1</sup> the Supreme Court of New Jersey said: "Contracts by independent and unconnected manufacturers or traders looking to the control of the prices of their commodities, either by limitation of production, or by restriction on distribution, or by express agreement to maintain specified prices, are, without doubt, opposed to public policy. . . . Corporations, however, may lawfully do any acts within the corporate powers conferred on them by legislative grant. . . . Under such powers, it is obvious that a corporation may purchase the plant and business of competing individuals and concerns. The legislature might have withheld such powers, or imposed limitations upon their use. In the absence of prohibition or limitation on their powers in this respect, it is impossible for the courts to pronounce acts, done under legislative grants, to be inimical to public policy. The grant of the legislature authorizing and permitting such acts must fix for the courts the character and limit of public policy in that regard. It follows that a corporation, empowered to carry on a particular business, may lawfully purchase the plant and business of competitors, although such purchases may diminish, or for a time at least, destroy, competition. Contracts for such purchases cannot be refused enforcement." <sup>2</sup>

for the purpose of taking their property. Any combination of competing corporations for the purpose of controlling prices, or limiting production, or suppressing competition, is contrary to public policy, and is void." See also *Yazoo, etc. R. Co. v. Searles*, 85 Miss. 520 (1905), (37 So. Rep. 939, 68 L. R. A. 723).

<sup>1</sup> *Trenton Potteries Co. v. Olyphant*, 58 N. J. Eq. 507 (1899), (43 Atl. Rep. 728, 78 Am. St. Rep. 612, 46 L. R. A. 255).

<sup>2</sup> So in *State v. Continental Tobacco*, 177 Mo. 1 (1903), (75 S. W. Rep. 737), it was held that a purchase by one corporation of the plants of other corporations of a similar nature to

These conclusions may be well founded in their application to an *actual* sale, as distinguished from a combination in the form of a sale.<sup>1</sup> A corporation, having general power to dispose of its property, may, like an individual, sell, in good faith, to a competing corporation without violating the rule of public policy.<sup>2</sup> There is no *combination* in such a purchase. But if

its own, if made in good faith in the legitimate pursuit of its business, was in the exercise of a legal right. The Court said, in effect, that the corporation had the same power as an individual to make such purchases.

And in *Dittman v. Distilling Co.*, 64 N. J. Eq. 537 (1903), (54 Atl. Rep. 576), where it was charged that a corporation organized for the express purpose of acquiring and holding stocks in other corporations was unlawful as constituting a monopoly, it was held that as such monopoly, if it existed, arose from the exercise of the power conferred upon the corporation by its charter to purchase stocks, the exercise of such power would not be enjoined in the suit of a stockholder — that the question could only be determined in *quo warranto* proceedings instituted by the Attorney-general to oust the corporation from its franchises.

See also *Metcalf v. American School Furniture Co.*, 122 Fed. 115 (1903).

<sup>1</sup> In *Shawnee Compress Co. v. Anderson*, 28 Sup. Ct. Rep. 572 (1908), the Supreme Court of the United States said: "This case presents something more than a lease of property by the Shawnee Company, induced or made necessary by financial embarrassment. It presents something more than the acquisition by the Gulf Company of another compress — of a mere addition to its business. It presents acts in said monopoly."

*Davis v. A. Booth & Co.*, 131 Fed. 37 (1904): "There is a clear distinction, which seems to be lost sight of in the argument here, between the

aggregation of properties by purchase when the seller no longer retains an interest in the property, and a combination of owners and properties under one management where such owners' interest is continued in the combination."

See also cases cited in note to § 360, *post*: "*Associations of Manufacturers and Producers.*"

*National Lead Co. v. Grote Paint Store Co.*, 80 Mo. App. 267 (1899): "The record in the case under review shows that the beneficial owners of the property were the subscribers to the National Lead Trust and holders of its certificates, and that these same persons remained the beneficial owners of the same property after it was converted into the capital of the plaintiff corporation, the only difference being that each holder of a trust certificate received, in lieu thereof, shares of stock in the new corporation at an agreed rate of exchange, and the further fact that the legal title to the property was put into a corporate entity of a body of nine trustees appointed under the trust agreement. The sale itself was titular rather than real."

<sup>2</sup> In *Carter-Crume Co. v. Peurrung*, 86 Fed. 439 (1898), the plaintiff entered into contracts with several manufacturers of butter-dishes for the purchase of their products. Its purpose was to control the market for these articles, but the manufacturers had no knowledge of, and did not participate in, such unlawful purpose. In sustaining one of these contracts the Court said: "The transaction with Peurrung Brothers

the sale is for the purpose of forming a corporate combination, in which the vendor corporation or its stockholders participate, the same rule of public policy is applicable as in the case of any combination of corporations. As already stated, the object of a combination, or the necessary or natural consequence of its operation, determines its legality. The form — trust, corporate combination or association — will not serve as a cloak for conspiracy nor prevent the application of the rule of public policy.<sup>1</sup>

Corporate power to purchase no more authorizes the exercise of such power for purposes opposed to public policy,

& Co. was, on its face, legitimate, and it cannot be impeached simply by evidence that the Carter-Crume Company understood and intended it as one step in a general illegal scheme for monopolizing the trade in wooden butter-dishes and controlling prices.”

<sup>1</sup> In considering this subject these propositions must be clearly borne in mind:

(1) A corporation authorized to purchase the properties or shares of other corporations has no greater power than an individual — that which is unlawful on the part of the latter is unlawful on the part of the former.

(2) Whether a transaction is a sale or a combination depends primarily upon whether the vendor corporation or its stockholders retain an interest in the united properties.

The fallacy of the argument in *Trenton Potteries Co. v. Olyphant*, *supra*, lies in the assumption that general corporate power to purchase is equivalent to express power to form a corporate combination. Power conferred upon a corporation to purchase the properties or shares of other corporations gives it the same power — and no more — possessed by an individual. An individual manufacturer might purchase the plant of a competing corporation.

If there were no element of combination present the purchase would be valid. So a corporation, with power to purchase, might make a similar acquisition. But the individual would have no right to enter into a combination with the competing corporation in the form of a sale. Nor would its charter powers authorize the corporation to do so. The grant by the legislature of the power to purchase fixes the public policy of the State with respect to a *purchase*. Express statutory authority to form a combination would be necessary to fix the policy regarding a *corporate combination*.

As we have seen, the statutes of many States authorize the consolidation of corporations. These statutes determine the policy of the States where they are enacted regarding the particular union of stocks and properties therein authorized. But no State has enacted statutes authorizing the combination of corporations in looser form. Until such statutes shall have been adopted the rules of public policy regarding combinations must be considered as applying in the same degree to corporations as to individuals.

Whether a transaction between corporations or between individuals amounts to a sale or to a combination depends upon whether the vendor

than a general power to make contracts authorizes the execution of agreements conflicting with the public interests.<sup>1</sup>

§ 355. **Analysis of Rule — (B) Objects and Tendencies of Combinations.** — Where the objects and purposes of a combination of corporations, as stated in the instruments of its formation, are, upon their face, contrary to public policy, the combination is, manifestly, void. But an affirmation of purposes inimical to public policy is hardly to be expected from the organizers of a combination, and the law does not place a premium upon evasion by making the test of validity the object stated.<sup>2</sup> On the contrary, the court, in determining the validity of a combination, upon grounds of public policy, should place itself in the position of its members at the time of its formation, and, from that point of view,

actually parts with all interest in the property sold or merely changes the form of the investment. A *bona fide* sale of a plant for cash or its equivalent possesses none of the elements of combination. On the other hand, an exchange of one plant for an interest in united plants possesses all the elements of combination. How this exchange is effected is immaterial. An ordinary method is to pay the purchase price in the shares of the corporate combination. Sometimes these shares are delivered to the vendor corporation; sometimes they are distributed directly among its stockholders. It is not material which course is taken. In such a transaction the stockholders — the ultimate owners — stand for their corporation.

<sup>1</sup> As to the *power* of a corporation to purchase competing plants for the purpose of suppressing competition, see *Distilling, etc. Co. v. People*, 156 Ill. 448, 491 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200), where the Court said: "But it is urged that the defendant, by its charter, is authorized to purchase and own distillery property, and that there is no limit

placed upon the amount of property which it may thus acquire. By its certificate of organization, it is authorized to engage in a general distillery business in Illinois and elsewhere, and to own the property necessary for that purpose.

The defendant is authorized to own such property as is necessary for carrying on its distillery business, and no more. Its power to acquire and hold property is limited to that purpose; and it has no power, by its charter, to enter upon a scheme of getting into its hands and under its control all, or substantially all, the distillery plants and the distillery business of the country, for the purpose of controlling production and prices, of crushing out competition, and of establishing a virtual monopoly in that business."

<sup>2</sup> *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906), (56 S. E. Rep. 264, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268): "Conceding for the sake of the argument that the purpose stated is lawful, we are not limited in ascertaining the real purpose of the contract, to a consideration of the purpose stated." (Citing this section.)

determine the real, and not the ostensible, purpose of the combination.<sup>1</sup>

As said by Judge Daniels in the *Sugar Trust Case*:<sup>2</sup> "The law does not require that instruments of this description, before they may be declared to be illegal, shall, in plain language affirm the intention to be to prevent competition and control the market, or advance the prices of necessary commodities. . . . But the courts, as in other cases, are permitted to place themselves in the position of the parties entering into the agreement or arrangement to discover the objects or designs by which they may have been actuated."

Moreover, in determining the validity of a combination upon principles of public policy, its actual effect when put into operation is immaterial. The question is not what has been done under the combination but what might have been done, or might be done, under it.<sup>3</sup> The inquiry is whether a natural

<sup>1</sup> *Detroit Salt Co. v. National Salt Co.*, 134 Mich. 120 (1903), (96 N. W. Rep. 1): "It is obvious that, so long as combinations in restraint of trade are profitable, there will be found those whose desire for gain will overcome their reverence for law, and even lead them to dare the dangers of criminal prosecution; and it is not unreasonable to suppose that in their contracts they will endeavor to give the appearance of lawful transactions. In making this contract before us the parties had difficulty in avoiding illegal provisions, and, if defendant is right about the case, the safeguards of the contract are to be found in the provisions contemplating its breach. In a question of this kind it is proper to show the circumstances attending the making of the contract, the object and purpose in view, and the construction placed upon it by the parties, as evidenced by their dealings under it."

*Wilson v. Morse*, 117 Iowa, 581, 584 (1902), (91 N. W. Rep. 823): "The contract being legal on its face, the burden was on defendants to show its illegality by satisfactory and

convincing evidence. If made to prevent competition, or to fix the price to be paid for grain in the territory where it was to be operative, it was, of course, contrary to public policy and void. . . . Whether the parties had in mind either of these purposes is a question of fact to be determined from the evidence."

See also *Southern Electric Securities Co. v. State* (Miss. 1907), 44 So. Rep. 785; *Dunbar v. American Telephone, etc. Co.*, 224 Ill. 9 (1906), (79 N. E. Rep. 423, 115 Am. St. Rep. 132); *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906), (56 S. E. Rep. 264, 116 Am. St. Rep. 901, 10 L. R. A. (N.S.) 268).

<sup>2</sup> *People v. North River Sugar Ref'g Co.*, 54 Hun (N. Y.), 376 (1889), (3 N. Y. Supp. 401).

<sup>3</sup> *People v. Sheldon*, 139 N. Y. 251 (1893), (34 N. E. Rep. 785, 36 Am. St. Rep. 690, 23 L. R. A. 221): "The question here does not turn on the point whether the agreement between the retail dealers in coal did, as a matter of fact, result in injury to the public, or to the community in Lock-

result of the operation of the combination would be prejudicial to the public interests.<sup>1</sup>

The courts have generally held that a combination is void as being against public policy, the tendency of which is injurious to the public.<sup>2</sup> Testing the validity of acts or contracts by

port. The question is, Was the agreement one, in view of what might have been done under it and the fact that it was an agreement, the effect of which was to prevent competition among the coal dealers, one upon which the law fastens the brand of condemnation?"

*Judd v. Harrington*, 139 N. Y. 105 (1893), (34 N. E. Rep. 790): "Courts will not aid parties seeking to enforce such an agreement, irrespective of the question whether, in fact, it produced the evil results to which it tended, or was harmless. . . . The illegal character of the agreement appeared upon its face, and was a necessary legal conclusion from its provisions."

*Harding v. American Glucose Co.*, 182 Ill. 615 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738): "The material consideration in the case of such combinations is, as a general thing, not that prices are raised, but that it rests in the power and discretion of the trust or combination, taking all the plants of the several corporations, to raise prices at any time, if it sees fit to do so." See also *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906), (56 S. E. Rep. 273, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268).

But in *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 428 (1904), (75 Pac. Rep. 89), the Supreme Court of Montana refused to follow the rule stated in *Harding v. American Glucose Co.*, *supra*, that mere possession of power to repress competition is sufficient to constitute an unlawful combination, and held that competition must be actually repressed before there is any illegality.

<sup>1</sup> *Texas Standard Oil Co. v. Adoue*, 83 Tex. 650 (1892), (19 S.W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598): "The agreement may be illegal if the natural or necessary consequences of its operation are to prevent competition and create fictitious prices independent of the law of demand and supply and to such an extent as to injuriously affect the interests of the public, or the interests of any particular class of citizens who may be especially interested, either as producers or consumers, in the articles or staples which are the subject of the restrictions imposed by the contract."

<sup>2</sup> *Anheuser-Busch Brew. Ass'n v. Houck* (Tex. 1894), 27 S. W. Rep. 696: "The effect on the public of an agreement which is against public policy is not essential; the tendency is enough to bring it within the condemnation of the courts."

*Nester v. Continental Brewing Co.*, 161 Pa. St. 481 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894): "Courts will not stop to inquire as to the degree of injury inflicted. It is enough to know that the natural tendency of such contracts is injurious."

*Central Ohio Salt Co. v. Guthrie*, 35 Ohio St. 672 (1880): "The clear tendency of such an agreement is to establish a monopoly and destroy competition in trade, and, for that reason, on grounds of public policy, courts will not aid in its enforcement. It is no answer to say that competition in the salt trade was not, in fact, destroyed, or that the price of the commodity was not unreasonably advanced. Courts will not stop to inquire as to the degree of injury inflicted upon the public; it is enough

their tendencies, real or supposed, is making a standard of that which is essentially uncertain and indefinite. Two courts may honestly disagree as to the tendency of a particular agreement, and the phrase "injurious tendency" is too often a generality taking the place of exact reasoning. The distinction between the natural consequences of the operation of a combination and its tendencies may be slight, but it is essential.

§ 356. **Analysis of Rule — (C) Control of the Market.** — The phrase "control of the market,"<sup>1</sup> as employed in the rule of public policy, means the control of the disposition of a given product in a given market. It involves, primarily, the suppression of competition, and, as incidental thereto:

- (1) The control of production.
- (2) The regulation of prices.

It is not essential, however, to the control of the market, within the rule, that it should be complete. Practical con-

to know that the inevitable tendency of such contracts is injurious to the public."

*Walter A. Wood Mowing, etc. Mach. Co. v. Greenwood Hardware Co.*, 75 S. C. 383 (1906), (55 S. E. Rep. 973): "The main general test should be whether the contract, trust or combination is monopolistic in purpose or natural tendency."

*Brown v. Jacobs' Pharmacy Co.*, 115 Ga. 429, 433 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547): "It is the nature or character and tendency of the agreement which renders it objectionable whether in fact the parties to it succeed in restraining trade generally, or stifling competition, or not."

*Richardson v. Buhl*, 77 Mich. 660 (1889), (43 N. W. Rep. 1102, 6 L. R. A. 457), (*Champlin, J.*, concurring opinion): "Such a vast combination as has been entered into under the above name is a menace to the public. Its object and direct tendency is to prevent free and fair competition, and control the prices throughout the national domain."

See also *Addyston Pipe, etc. Co. v.*

*United States*, 175 U. S. 211 (1899), (20 Sup. Ct. Rep. 96); *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540); *State v. Portland Natural Gas, etc. Co.*, 153 Ind. 483 (1899), (53 N. E. Rep. 1089, 74 Am. St. Rep. 314, 53 L. R. A. 415); *Stanton v. Allen*, 5 Denio (N. Y.), 434 (1848), (49 Am. Dec. 282); *State v. Nebraska Distilling Co.*, 29 Neb. 700 (1890), (46 N. W. Rep. 155); *Distilling and Cattle Feeding Co. v. People*, 156 Ill. 448 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200); *Sanford v. People*, 121 Ill. App. 619 (1905); *Slaughter v. Thacker Coal, etc. Co.*, 55 W. Va. 642 (1904), (47 S. E. Rep. 247, 104 Am. St. Rep. 1013, 65 L. R. A. 342).

<sup>1</sup> The term "monopoly" has, likewise, been defined as "the control of a given product in a given market." While, for reasons already indicated, the use of the term "monopoly" is undesirable in stating a rule of public policy, the decisions of the courts which use the term in the sense stated may properly be referred to as illustrating the rule.



trol is sufficient; and this does not imply an absolute elimination of competition.<sup>1</sup>

On the other hand, a mere restriction of competition does not give control of the market and is not unlawful.<sup>2</sup> The

<sup>1</sup> *United States v. E. C. Knight Co.*, 156 U. S. 16 (1894), (15 Sup. Ct. Rep. 249): "Again, all the authorities agree that in order to vitiate a contract or combination it is not essential that its result shall be a complete monopoly; it is sufficient if it really tends to that end and to deprive the public of the advantages which flow from free competition."

*Klingel's Pharmacy v. Sharp*, 104 Md. 218, 230 (1906), (64 Atl. Rep. 1029, 118 Am. St. Rep. 399, 7 L. R. A. (N. S.) 976): "When the direct and inviolate effects of a contract or combination among particular dealers in a commodity is to destroy competition between them and others, so that the parties to the contract or combination may obtain increased prices for themselves, such contract or combination amounts to a restraint in trade of the commodity, even though contracts to buy such commodity at the enhanced price are constantly being made. Total suppression of trade in the commodity is not necessary in order to make the contract one in restraint of trade."

*De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.*, 16 Daly (N. Y.), 529 (1891), (14 N. Y. Supp. 277): "Neither need the agreement nor combination, in order to expose it to the denunciation of the law, constitute a complete monopoly or effect a total suppression of competition; but the language of courts and of writers is that, if the agreement tends to a monopoly or to reduce or lessen competition, it is contrary to public policy and unlawful, because operating *pro tanto* an artificial enhancement of price."

In the *Sugar Trust Case* (*People v. North River Sugar Ref'g Co.*, 54 Hun (N. Y.), 354, note (1889)), Judge Bar-

rett said: "This rule is applicable to every monopoly, whether the supply is restricted by nature or susceptible of indefinite production. The difficulty of effecting the unlawful purpose may be greater in one case than in the other, but it is never impossible. Nor need it be permanent or complete. It is enough that it may be even temporarily and partially successful."

See also *Texas Standard Oil Co. v. Adoue*, 83 Tex. 650 (1892), (19 S. W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598). Also *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 211 (1899), (20 Sup. Ct. Rep. 108); *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1907), (56 S. E. Rep. 264, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268); *Dunbar v. American Telephone, etc. Co.*, 224 Ill. 9 (1906), (79 N. E. Rep. 423, 115 Am. St. Rep. 132); *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904); *State v. Armour Packing Co.*, 173 Mo. 356 (1903), (73 S. W. Rep. 645, 61 L. R. A. 464); *Brown v. Jacobs' Pharmacy Co.*, 115 Ga. 429 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547).

<sup>2</sup> Public policy regarding competition, as manifested by divergent judicial decisions, is indicated by the following extracts from opinions of courts in different States and in England:

*California.* *Herriman v. Menzies*, 115 Cal. 22 (1896), (44 Pac. Rep. 660, 56 Am. St. Rep. 82, 35 L. R. A. 318): "Combinations between individuals or firms for the regulation of prices, and of competition in business, are not monopolies, and are not unlawful as in restraint of trade, so long

commercial maxim, "competition is the life of trade," while not adopted as a maxim of jurisprudence, finds a place in

as they are reasonable, and do not include all of a commodity or trade, or create such restrictions as to materially affect the freedom of commerce."

*Compare Santa Clara Valley Mill, etc. Co. v. Hayes*, 76 Cal. 392 (1888), (18 Pac. Rep. 391, 9 Am. St. Rep. 211): "When agreements are resorted to for the purpose of taking trade out of the realm of competition, and thereby enhancing or depressing prices of commodities, the courts cannot be successfully invoked, and their execution will be left to the volition of the parties thereto."

*Illinois. Harding v. American Glucose Co.*, 182 Ill. 615 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 235, 64 L. R. A. 738): "Any combination of competing corporations for the purpose of controlling prices, or limiting production, or suppressing competition, is contrary to public policy and is void. . . . The public policy of the State of Illinois has always been against trusts and combinations organized for the purpose of suppressing competition and creating monopoly."

See also *ante*, § 344: "*Basis of Rules—(C) Whiskey Trust Cases*"; *ante*, § 345: "*Basis of Rules—(D) Case of the Preservers Trust*"; *ante*, § 346: "*Basis of Rules—(E) Case of the Chicago Gas Trust*."

*Indiana. State v. Portland National Gas, etc. Co.*, 153 Ind. 483 (1899), (53 N. E. Rep. 1089, 74 Am. St. Rep. 314, 53 L. R. A. 415): "It is an old and familiar maxim that 'competition is the life of trade,' and whatever act destroys competition, or even relaxes it, upon the part of those who sustain relations to the public, is regarded by the law as injurious to public interests, and is, therefore, deemed to be unlawful, on

the grounds of public policy." See also *Over v. Byram Foundry Co.*, 37 Ind. App. 452 (1906), (77 N. E. Rep. 302).

*Kentucky. Anderson v. Jett*, 89 Ky. 375 (1889), (12 S. W. Rep. 670, 6 L. R. A. 390): "Rivalry is the life of trade. The thrift and welfare of the people depend upon it. Monopoly is opposed to it all along the line. The accumulation of wealth out of the brow sweat of honest toilers by means of combinations is opposed to competing trade and enterprise. That public policy that encourages fair dealing, honest thrift and enterprise among all the citizens of the commonwealth, and is opposed to monopolies and combinations because unfriendly to such fair dealing, thrift and enterprise, declares all combinations whose object is to destroy or impede free competition between the several lines of business engaged in utterly void."

*Michigan. See ante*, § 347: "*Basis of Rules—(F) Case of the Diamond Match Company*."

*New Hampshire. Manchester, etc. R. Co. v. Concord R. Co.*, 66 N. H. 127 (1889), (20 Atl. Rep. 383, 49 Am. St. Rep. 582): "While, without doubt, contracts which have a direct tendency to prevent a healthy competition are detrimental to the public, and, consequently, against public policy, it is equally free from doubt that when such contracts prevent an unhealthy competition . . . they are beneficial, and in accord with sound principles of public policy."

*New Jersey. Meredith v. Zinc and Iron Co.*, 55 N. J. Eq. 221 (1897), (37 Atl. Rep. 539): "Now, I am unable to find any foundation, either in law or in morals, for the notion that the public have the right to have these

many decisions, and the language of the courts is often broad enough to include, as opposed to public policy, every com-

private owners of this sort of property continue to do business in competition with each other. No doubt the public has reasonable ground to entertain its hope and expectation that its individual members will generally, in their several struggles to acquire the means of comfortable existence, compete with each other. But such expectation is based entirely upon the exercise of the free will and choice of the individual, and not upon any legal or moral duty to compete, and can never, from the nature of things, become a matter of right on the part of the public against the individual." See also *Trenton Potteries Co. v. Olyphant*, 58 N. J. Eq. 507 (1899), (43 Atl. Rep. 723, 78 Am. St. Rep. 612, 46 L. R. A. 255).

*New York. Vinegar Co. v. Foehrenbach*, 148 N. Y. 64 (1895), (42 N. E. Rep. 403): "But not all combinations are condemned, and self-preservation may justify the prevention of undue and ruinous competition, when the prevention is sought by fair and legal methods."

*Judd v. Harrington*, 139 N. Y. 105 (1893), (34 N. E. Rep. 790): "The real purpose and intent of the agreement was to suppress competition in an article of food, and as such agreements tend to advance the price, they are regarded as detrimental to the public interest, and contrary to public policy."

*Diamond Match Co. v. Roeber*, 106 N. Y. 483 (1887), (13 N. E. Rep. 419, 60 Am. Rep. 464): "We suppose a party may legally purchase the trade and business of another for the very purpose of preventing competition."

*Cohen v. Berlin and Jones Envelope Co.*, 38 App. Div. (N. Y.) 499 (1899), (56 N. Y. Supp. 588): "It cannot be doubted but that the defendant had

the right to buy out all the envelope manufacturing business, and even though they thereby obtained power to end competition and arbitrarily fix prices."

*Rafferty v. Buffalo City Gas Co.*, 37 App. Div. (N. Y.) 623 (1899), (56 N. Y. Supp. 288): "A contract made to prevent or avoid destructive competition is not necessarily invalid."

*Chappell v. Brockway*, 21 Wend. 157 (1839): "Competition in business, though greatly beneficial to the public, may be carried to such an extent as to become an evil."

See also *ante*, § 342: "*Basis of Rules — (A) Case of the Sugar Trust.*"

*Ohio. Central Ohio Salt Co. v. Guthrie*, 35 Ohio St. 672 (1880): "Public policy, unquestionably, favors competition in trade, to the end that its commodities may be afforded to the consumer as cheaply as possible, and is opposed to monopolies, which tend to advance market prices, to the injury of the general public."

See also *ante*, § 343: "*Basis of Rules — (B) Case of the Standard Oil Trust.*"

*Pennsylvania. Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 186 (1871), (8 Am. Rep. 159): "When competition is left free, individual error or folly will generally find a correction in the conduct of others. But here is a combination of all the companies operating in the Blossburg and Barclay mining regions, and controlling their entire productions. . . . The public interest must succumb to it, for it has left no competition free to correct its baleful influence."

*Rhode Island. Oakdale Mfg. Co. v. Garst.*, 18 R. I. 484 (1894), (28 Atl. Rep. 973, 49 Am. St. Rep. 784, 23 L. R. A. 639): "Undoubtedly, there may be combinations so destructive of

bination in restraint of competition, regardless of degree. But the weight of authority — as well as sound principle — supports the view that every combination restricting competition is not invalid — that restriction, to be unlawful, while not necessarily amounting to total suppression, must give, substantially, the control of the market.

Just where the line is to be drawn between a lawful and unlawful restriction of competition — just what restriction is practical suppression — must depend largely upon the facts and circumstances of each case. As said in *Hoffman v. Brooks*,<sup>1</sup> a case not officially reported: "Those engaged in any trade or business may, to such limited extent as may be fairly necessary to protect their interests, enter into agreements

the right of the people to buy and sell, and to pursue their business freely, that they must be declared to be void upon the ground of public policy. In such cases, the injury to the public is the controlling consideration. But it does not follow that every combination in trade, even though such combination may have the effect to diminish the number of competitors in business, is illegal. . . . Combinations for mutual advantage which do not amount to a monopoly, but leave the field of competition open to others, are neither within the reason nor the operation of the rule."

*Texas.* *Texas Standard Oil Co. v. Adoue*, 83 Tex. 650 (1892), (19 S. W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598). See extract from this decision in note to last section.

*Wisconsin.* *Kellogg v. Larkin*, 3 Pin. 150 (1851), (56 Am. Dec. 180): "I apprehend it is not true that competition is the life of trade. On the contrary, that maxim is one of the least reliable of the host that may be picked up in every market-place. It is, in fact, the shibboleth of mere gambling speculation, and is hardly entitled to take rank as an axiom in the jurisprudence of this country. . . . Indeed, by reducing prices below, or raising them above values

(as the nature of the trade prompted), competition has done more to monopolize trade, or to secure exclusive advantages in it, than has been done by contract. Rivalry in trade will destroy itself, and rival tradesmen seeking to remove each other, rarely resort to contract, unless they find it the cheapest mode of putting an end to the strife."

*England.* *Mogul Steamship Co. v. McGregor*, L. R. App. Cas. 25 (1892), (61 L. J. R. 295), (Lord Bramwell): "In these days of instant communication with almost all parts of the world, competition is the life of trade, and I am not aware of any stage of competition called "fair" intermediate between lawful and unlawful. The question of fairness would be relegated to the idiosyncrasies of individual judges. I can see no limit to competition, except that you shall not invade the rights of another."

*Canada.* *Ontario Salt Co. v. Merchants Salt Co.*, 18 Grant's Ch. 540 (1871): "I know of no rule of law ever existing which prohibited a certain number (not all) of the producers of a staple commodity agreeing not to sell below a certain price."

<sup>1</sup> *Hoffman v. Brooks*, 11 Cincinnati Week. Law Bull. 259 (1884), 23 Am. Law Reg. 648.

which will result in diminishing competition and increasing prices. Just the extent to which this may be done the courts have been careful not to define, just as they have refused to set monuments along the line between fairness and fraud."

§ 357. **Analysis of Rule — (D) Extent of Territory.** — A combination to control the markets of the world for a useful commodity would contravene the rule of public policy. A combination for the purpose of controlling the market in a particular locality would be equally unlawful. The phrase "control of the market" means the control of any market.

No limit of territory can or should be prescribed. The dealers in a village might combine to control the market for a necessary of life. In order to accomplish their object, they must control the ordinary sources of supply of the village. Manufacturers throughout the United States might combine to control the markets of the country for their product. Their purpose could only be attained by having under their power the sources of supply of the country. The result to the public from each combination would be the same. Competition, in each case, would be suppressed, and, consequently, prices raised and production limited. The difference would be only in degree, and each combination would be against public policy and invalid.<sup>1</sup>

<sup>1</sup> *Texas Standard Oil Co. v. Adoue*, 83 Tex. 650 (1892), (19 S. W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598): "We can scarcely conceive how mere territorial limits can be the controlling test, in all instances, of the legality of the restraints imposed upon the ordinary course of trade. This criterion may do very well when applied to the occupation or profession of one man, or even a few individuals; for neither their labor, industry, business, nor services may be so necessary to the public as not to be dispensed with without inconvenience or injury. It appears to us, however, that the case is very different in regard to trade or commerce in those articles of prime necessity, or even of very frequent use among a large number of

people in any given locality. Does any one doubt that a combination of a number of the most extensive dealers in flour, meat, or oils, etc., in one great city, to sell those commodities at only one price or not at all, within the limits of that city, would affect the interests of the public, and, perhaps, also some of the individual dealers, much more extensively and disastrously than a similar agreement extended to a much greater area of country, but in which only a few people reside, or require such articles? It would seem that the injurious effects upon the public interests would be in proportion to the number of people affected by the restrictions, though we are not unaware that this position has not been deemed tenable

§ 358. **Analysis of Rule — (E) Useful Commodities.** — The old English offences of regrating, forestalling and engrossing, — crimes in the days of Edward VI. and approved methods of doing business at the present time, — related exclusively to certain forms of traffic in the *necessaries of life*.<sup>1</sup>

by some of the authorities in cases where the right to exercise a trade or profession within a particular district or locality has been restricted by the contract. We think that territory cannot be the sole test, though in the present instance the contract embraces such extensive territory, and such a number of localities, as to bring it even within that rule."

*Hoffman v. Brooks*, 11 Cincinnati Weekly Law Bull. (Ohio) 259 (1884), 23 Am. Law Reg. 648: "The presumption is always against the validity of such agreements [in restraint of competition], and, certainly, where they include all those engaged in any business in a large city or district, are unlimited in duration, and are manifestly intended, by the surrender of individual discretion, by the arbitrary fixing of prices, or by any of the methods to which the hope of gain makes human ingenuity so faithful, to strangle competition outright, and breed monopolies, the law, while it may not punish, will not enforce them."

*Chapin v. Brown*, 83 Iowa, 156 (1891), (48 N. W. Rep. 1074, 32 Am. St. Rep. 297, 12 L. R. A. 428): "The agreement is against public policy. It plainly tends to monopolize the butter trade at Storm Lake, and destroy competition in that business. It is not necessary that the enforcement of the agreement should actually create a monopoly in order to render it invalid, and, surely, where all the dealers in a commodity in a certain locality agree to quit the business, and the plaintiffs are installed as the only dealers in that line, the tendency is, for a time, at least, to

destroy competition, and leave the plaintiffs as the only dealers in that species of property in that locality. Such contracts cannot be enforced."

*Santa Clara Valley Mill, etc. Co. v. Hayes*, 76 Cal. 387 (1888), (18 Pac. Rep. 391, 9 Am. St. Rep. 211): "Here it [the plaintiff] entered into a contract with the object and view to suppress the supply and enhance the price of lumber in *four counties of the State*. The contract was void as being against public policy."

<sup>1</sup> "*Regrating*: In old English law, the offence of buying or getting into one's hands at a fair or market, any provisions, corn, or other dead victuals with the intention of selling the same again in the same fair or market, or in some other within four miles thereof, at a higher price. The offender was termed a 'regrator.'" Black's Law Dict.

"*Forestalling the Market*: The act of buying or contracting for any merchandise or provision on its way to the market, with the intention of selling it again at a higher price; or dissuading persons from bringing their goods or provisions there; or persuading them to enhance the price when there." Black's Law Dict. citing 4 Black Com. 158.

"*Engrossing*: Whatsoever person or persons that after said first day of May shall engross or get into his or their hands, by buying, contracting, or promise-taking, other than by demise, grant, or lease of land or tithe, any corn growing in the fields, or any corn or grain, butter, cheese, fish, or other dead victuals whatsoever, within the realm of *England*, to the intent to sell the same again, shall be accepted, re-

The influence of the early statutes and decisions against those offences has not yet entirely died out. The term "engross" is not infrequently used in connection with modern combinations, and the character of an article as one of "the necessities of life," as an "article of necessity" or "an article of prime necessity" — according to the particular phrase — is generally stated as a controlling reason why the suppression of competition therein is inimical to public policy.<sup>1</sup> A combination for the purpose of controlling the market for an article of necessity is against public policy. But the rule of public policy is of broader application.<sup>2</sup> The essential question is whether the article is a *useful commodity*,<sup>3</sup> as distinguished from

puted and taken as unlawful engrosser or engrossers." Statute 5th and 6th Edward VI., entitled, "An Act against Regraters, Foretallers, and Engrossers" (ch. 14, § 3).

The acts thus denominated offences are now recognized and approved as necessary methods of transacting business, and the change of public policy, with reference to them, furnishes an apt illustration of its fluctuating nature.

<sup>1</sup> Queen Ins. Co. v. State (Tex. Civ. App. 1893), 22 S. W. Rep. 1048: "As we have said, these statutes (against engrossing, regrating and forestalling) have been repealed in England. They were applicable to a condition of society which no longer exists. But it is to be presumed that the common-law principle which underlies them is the origin of the modern doctrine on the subject. We find that most of the cases in which agreements among manufacturers and dealers to increase the price of their wares and commodities were declared illegal, related to some merchantable article of necessity, or of great utility."

<sup>2</sup> In United States v. E. C. Knight Co., 156 U. S. 12 (1895), (15 Sup. Ct. Rep. 248), Mr. Chief Justice Fuller said: "The argument is, that the power to control the manufacture of

refined sugar is a monopoly over a necessary of life, to the enjoyment of which, by a large part of the population of the United States, interstate commerce is indispensable, and that, therefore, the general government, in the exercise of the power to regulate commerce, may repress such monopoly directly, and set aside the instruments which have created it. But this argument cannot be confined to necessities of life, merely, but must include all articles of general consumption."

See also DeWitt Wire Cloth Co. v. New Jersey Wire Cloth Co., 16 Daly (N. Y.), 529 (1891), (14 N. Y. Supp. 279), where the Court said: "Nor is the operation of the rule forbidding contracts restricting competition and enhancing price, limited to trade in the necessities of life, but, as appears from the citations above, extends equally and alike to all commodities of commerce."

<sup>3</sup> Queen Ins. Co. v. State (Tex. Civ. App. 1893), 22 S. W. Rep. 1048: "The word 'commodity' has two significations. In its most comprehensive sense, it means 'convenience, accommodation, profit, benefit, advantage, interest, commodiousness;' but, according to Webster's International Dictionary, the use of the word in this sense is obsolete. Page 286. The word is ordinarily

those "articles of commerce, which are, in no proper sense, necessities or even conveniences, but mere luxuries or appendages of vanity."<sup>1</sup>

No precise rule can be stated for determining what are articles of necessity.<sup>2</sup> The luxuries of the period of Edward VI. have

used in the commercial sense of any movable or tangible thing that is ordinarily produced or used as the subject of barter or sale."

<sup>1</sup> *Cummings v. Union Blue Stone Co.*, 164 N. Y. 405 (1900), (79 Am. St. Rep. 655, 52 L. R. A. 262).

In *Herriman v. Menzies*, 115 Cal. 16 (1896), (44 Pac. Rep. 660, 56 Am. St. Rep. 81, 35 L. R. A. 318), the Court said: "An agreement, the purpose or effect of which is to create a monopoly, is unlawful if it relate to some staple commodity, or thing, of general requirement and use, or of necessity, and not something of mere luxury or convenience."

<sup>2</sup> I. *Combinations for the suppression of competition in the sale or production of the following articles have been held to be inimical to public policy, generally upon the ground that they are necessities of life.*

*Alcohol.* *State v. Nebraska Distilling Co.*, 29 Neb. 718 (1890), (46 N. W. Rep. 155): "Alcohol is an article of commerce. It is applied to a thousand uses in arts and manufactures. The amount which is rectified and used as intoxicating drinks forms but a very small part of the quantity actually distilled, and being an article of commerce, any contract creating a monopoly therein, is against public policy and void."

*Beer.* Held: An article of daily consumption and a combination therein unlawful. *Nester v. Continental Brew. Co. (Pa.)*, 2 Dist. R. 177 (1894); on appeal, 161 Pa. St. 473 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894).

*Contra*, however, *Anheuser-Busch Brewing Ass'n v. Houck (Tex. 1894)*, (27 S. W. Rep. 692).

*Brick.* *Jackson v. Brick Ass'n*, 53 Ohio St. 303 (1895), (41 N. E. Rep. 257, 53 Am. St. Rep. 637, 35 L. R. A. 287).

*Blue Stone.* *Cummings v. Union Blue Stone Co.*, 164 N. Y. 405 (1900), (79 Am. St. Rep. 655, 52 L. R. A. 262).

*Biscuits and Confectionery.* *American Biscuit, etc. Co. v. Klotz*, 44 Fed. 721 (1891).

*Butter.* *Chapin v. Brown*, 83 Iowa, 156 (1891), (48 N. W. Rep. 1074, 32 Am. St. Rep. 297, 12 L. R. A. 428).

*Candles.* *Emery v. Ohio Candle Co.*, 47 Ohio St. 320 (1890), (24 N. E. Rep. 660, 32 Am. & Eng. Corp. Cas. 165, 21 Am. St. Rep. 819).

*Coal.* *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173. (1871), (8 Am. Rep. 159); *People v. Sheldon*, 139 N. Y. 251 (1893), (34 N. E. Rep. 785, 36 Am. St. Rep. 690, 23 L. R. A. 221); *Arnot v. Pittston, etc. Coal Co.*, 68 N. Y. 558 (1877), (23 Am. Rep. 190); *Drake v. Siebold*, 81 Hun (N. Y.), 178 (1894), (30 N. Y. Supp. 697).

*Coke.* *Pocahontas Coke Co. v. Powhatan Coal, etc.* (60 W. Va. 508 (1906), (56 S. E. Rep. 264, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268).

*Cotton Bagging.* *India Bagging Ass'n v. Kock*, 14 La. Ann. 169 (1859): "The agreement between the parties was palpably, and unequivocally, a combination in restraint of trade, and to enhance the price in the market of an article of prime necessity to cotton planters. Such combinations are contrary to public order, and cannot be enforced in a court of justice."



become the commonest of necessities, or have passed out of use altogether. In the present stage of civilization, the

*Cotton Seed.* Texas Standard Oil Co. v. Adoue, 83 Tex. 650 (1892), (19 S. W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598).

*Glucose and its Products.* Harding v. American Glucose Co., 182 Ill. 551 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 235, 64 L. R. A. 738).

*Grain.* Craft v. McConoughby, 79 Ill. 346 (1875), (22 Am. Rep. 171).

*Grain Bags and Burlap.* Pacific Factor Co. v. Adler, 90 Cal. 110 (1891), (27 Pac. Rep. 361, 25 Am. St. Rep. 102).

*Ice.* Griffin v. Piper, 55 Ill. App. 213 (1894).

*Lumber.* Santa Clara Valley Mill, etc. Co. v. Hayes, 76 Cal. 387 (1888), (18 Pac. Rep. 391, 9 Am. St. Rep. 211).

*Matches.* Richardson v. Buhl, 77 Mich. 632 (1889), (43 N. W. Rep. 1102, 6 L. R. A. 457).

*Milk.* People v. Milk Exchange, 145 N. Y. 267 (1895), (39 N. E. Rep. 1062, 45 Am. St. Rep. 609, 27 L. R. A. 437); Ford v. Chicago Milk Shippers Ass'n, 155 Ill. 166 (1895), (39 N. E. Rep. 651, 27 L. R. A. 298).

*Petroleum and its Products.* State v. Standard Oil Co., 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145).

*Preserves.* American Preservers Trust v. Taylor Mfg. Co., 46 Fed. 152 (1891); Bishop v. American Preservers Trust, 157 Ill. 284 (1895), (41 N. E. Rep. 765, 48 Am. St. Rep. 317).

*Salt.* Central Ohio Salt Co. v. Guthrie, 35 Ohio St. 666 (1880).

*Sheep and Lambs.* Judd v. Harrington, 139 N. Y. 105 (1893), (34 N. E. Rep. 790).

*Spring Tooth Harrows.* National Harrow Co. v. Bement, 21 App. Div. (N. Y.) 296 (1897), (47 N. Y. Supp. 462): "A harrow is an implement as

important and as generally used by farmers as a plough, and is quite as necessary for the proper cultivation of land as any other agricultural implement, and is in use in every properly cultivated farm. I think it needs no argument to show that a combination formed for the purpose of controlling their prices, limiting their production, preventing competition among manufacturers, and also preventing further improvement in them, is contrary to public policy."

*Sugar.* People v. North River Sugar Ref'g Co., 54 Hun (N. Y.), 354 (1889), (3 N. Y. Supp. 401); affirmed upon principles of corporation law, 121 N. Y. 582 (1890), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33).

*Tobacco.* Hoffman v. Brooks, 23 Am. Law Reg. 648 (1884), (11 Week. Law Bull. (Ohio) 258).

*Wire Cloth.* De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co., 16 Daly (N. Y.), 529 (1891), (14 N. Y. Supp. 277).

II. *The following articles have been held not to be articles of necessity:*

*Curtain Fixtures.* Central Shade Roller Co. v. Cushman, 143 Mass. 364 (1887), (9 N. E. Rep. 629): "The agreement does not refer to an article of prime necessity nor to a staple of commerce, nor to merchandise to be bought and sold in the market, but to a particular curtain fixture of the parties' own manufacture."

*Glue made from Fish Skins.* Gloucester Isinglass, etc. Co. v. Russia Cement Co., 154 Mass. 92 (1891), (27 N. E. Rep. 1005, 26 Am. St. Rep. 214, 12 L. R. A. 563).

*Laundry Machines.* Dolph v. Troy Laundry Mach. Co., 28 Fed. 553 (1886).

*Zinc.* Meredith v. Zinc, etc. Co.,

line between necessities and luxuries cannot be sharply drawn.<sup>1</sup>

A *fortiori* it is impossible to lay down an exact rule for determining what is a useful commodity. There are few articles which are bought and sold which are not, in a sense, useful, and, consequently, few articles which are not within the rule of public policy; except, perhaps, articles the use of which public policy requires should be restricted.<sup>2</sup>

55 N. J. Eq. 211 (1897), (37 Atl. Rep. 539).

All these articles are, however, useful commodities within the rule of public policy.

<sup>1</sup> *Brown v. Jacobs' Pharmacy Co.*, 115 Ga. 433 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547): "Again, some courts have sought to draw a distinction between what they term 'necessaries' or 'the necessities of life,' or 'prime necessities, and contracts or agreements with reference to other articles of commerce or merchandise. But this distinction is not well founded. What is at one time a luxury at another is a necessity. The things which were considered sufficient to satisfy the description of 'necessaries' a few years ago will be considered wholly insufficient now, under present conditions of civilization. How useful must a thing become before it enters the catalogue of necessities, so that contracts to restrain trade in regard to it, or to foster monopoly in it, are void?"

<sup>2</sup> *Anheuser-Busch Brewing Ass'n v. Houck* (Tex. 1894), (27 S. W. Rep. 695): "We think there can be no doubt that the rule that is to be derived from all the authorities condemns, as being against public policy, an agreement between two or more dealers, in an article of prime necessity or in general use among the people, whereby they agree to jointly control the supply of such article, to cease competition between themselves in

respect to it, and to regulate the price thereof in a given community or market. . . . There may be a question as to whether beer is an article of necessity, but it admits of no question that it is an article of usual and general consumption and of use among the people. . . . Is beer one of those articles of consumption, though one in frequent use among the people, the sale of which is not permitted by public policy to be limited by a contract in restraint of trade? We have concluded that it is not. The policy of the laws of the State is not towards the unrestricted or general sale of such article. The liquor traffic has always been kept in restraint by statutes imposing onerous conditions and regulations in reference to its pursuits, clearly evidencing a policy of not allowing every one to engage in the business at will."

*Compare*, however, *Nester v. Continental Brewing Co.*, 161 Pa. St. 473 (1894), (20 Atl. Rep. 102, 41 Am. St. Rep. 894), where the Court said: "The appellants insist that restraint of trade in the necessities of life only, is within the prohibition of public policy. No standard has been furnished by which to ascertain what constitutes these with reference to the general public. But assuming that beer is not among them, it is equally within the reach of the rule. The law recognizes it as a commodity, regulates its sales, it is 'an article of daily consumption,' and the court should refuse to aid in any attempted

§ 359. **Analysis of Rule of Public Policy applicable to Quasi-public Corporations.** — While combinations of private corporations merely for the purpose of restricting competition are not invalid,<sup>1</sup> similar combinations of *quasi*-public corporations are, presumptively, against public policy.<sup>2</sup> The rule provides that every such combination is invalid if either of these consequences may follow its operation:

- (1) The increase of charges beyond reasonable rates.
- (2) The curtailment of facilities afforded the public.

The substance of the rule is that every combination of *quasi*-public corporations, which, without statutory authority, does or may deprive the public of the benefits accruing from separate control and management, is against public policy.<sup>3</sup>

imposition upon the public by means of illegal combinations."

<sup>1</sup> *United States v. Trans-Missouri Freight Ass'n*, 58 Fed. 84 (1893) (24 L. R. A. 73), *reversed* on other grounds, 166 U. S. 324 (1897), (17 Sup. Ct. Rep. 540): "Another distinction which is now firmly established and enforced grows out of the nature of the business contracted about, and the relation the contracting parties bear thereto. An individual or a private corporation engaged in a purely private enterprise may lawfully enter into contracts or combination in regard thereto which would be invalid and illegal if the business was of a public nature, and the corporation was created for the purpose of engaging therein."

*Southern Electric Sec. Co. v. State*, (Miss. 1907), 44 So. Rep. 789: "The argument of counsel that a public corporation may do whatever an individual may do is not true in its broadest aspect. An individual owns property unaffected by a necessity to use it in the performance of duties in which the public have an interest, and is not restrained by charter limitations."

<sup>2</sup> In *Cleveland, etc. R. Co. v. Closser*, 126 Ind. 360 (1890), (26 N. E. Rep. 159, 22 Am. St. Rep. 593, 9 L. R.

A. 754) the Supreme Court of Indiana said: "It is, however, both appropriate and necessary to adjudge that a combination between common carriers to prevent competition is, at least, *prima facie* illegal. The doubt is as to whether any ultimate purpose can save it from the condemnation of the law; there can be no doubt that, unexplained, such a combination, for such a purpose, is condemned by public policy. If such a combination can, in any event, be admitted to be legal, it can only be so when it is affirmatively shown that its object was to prevent ruinous competition, and that it does not establish unreasonable rates, unjust discriminations, or oppressive regulations. If such a contract can stand, it must be upon an affirmative showing, and one so full, complete, and clear as to remove the presumption (to which its existence, in itself, gives rise) that it was formed to do mischief to the public by repressing fair competition."

<sup>3</sup> *United States v. Gibbs v. Consolidated Gas Co.*, 130 U. S. 408 (1889), (9 Sup. Ct. Rep. 553): *Chicago, etc. R. Co. v. Wabash, etc. R. Co.*, 61 Fed. 996 (1894).

*Illinois v. People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep.

## CHAPTER XXXVI

## APPLICATION OF RULES OF PUBLIC POLICY TO PARTICULAR CLASSES OF COMBINATIONS

- § 360. Associations of Manufacturers and Producers.
- § 361. Associations of Manufacturers owning Patents.
- § 362. Associations of Dealers.
- § 363. Associations of Railroad Companies — (A) Traffic Contracts of Connecting Lines.
- § 364. Associations of Railroad Companies — (B) Traffic Contracts of Competing Lines.
- § 364a. Associations of Railroad Companies — (C) Pools.
- § 365. Associations of Gas Companies and Other *Quasi*-public Corporations.

§ 360. **Associations of Manufacturers and Producers.** — The application of the rule of public policy to trusts and corporate combinations formed by manufacturing and producing companies has been illustrated in the leading cases of combinations of that description which have already been reviewed.<sup>1</sup>

Associations of competing manufacturers or producers, for the purpose of obtaining control of the market for their products, or for the restriction of competition, have been repeatedly entered into, and their validity has, in many cases, been passed upon by the courts.<sup>2</sup>

319, 8 L. R. A. 497); *Chicago Gas Light, etc. Co. v. Peoples Gas Light, etc. Co.*, 121 Ill. 530 (1887), (13 N. E. Rep. 169, 2 Am. St. Rep. 124).

*New York: Compare Rafferty v. Buffalo City Gas Co.*, 37 App. Div. 618 (1899), (56 N. Y. Supp. 288).

*West Virginia: West Virginia Transp. Co. v. Ohio River Pipe Line Co.*, 22 W. Va. 625 (1883), (46 Am. Rep. 527).

<sup>1</sup> See ante, § 342: "*Basis of Rules — (A) Case of the Sugar Trust*"; ante, § 343: "*Basis of Rules — (B) Case of the Standard Oil Trust*"; ante, § 344: "*Basis of Rules — (C) Whiskey Trust Cases*"; ante, § 345: "*Basis of Rules — (D) Case of the Preservers Trust*"; ante, § 347: "*Basis of Rules — (F) Case of*

*the Diamond Match Company*"; ante, § 348: "*Basis of Rules — (G) Case of the Glucose Combination*"; ante, § 349: "*Basis of Rules — (I) Miscellaneous Cases.*"

<sup>2</sup> I. Cases holding associations of competing manufacturers or producers legal:

*United States: Dolph v. Troy Laundry Mach. Co.*, 28 Fed. 553 (1886).

*Massachusetts: Gloucester Isinglass, etc. Co. v. Russia Cement Co.*, 154 Mass. 92 (1891), (27 N. E. Rep. 1005, 26 Am. St. Rep. 214, 12 L. R. A. 563); *Central Shade Roller Co. v. Cushman*, 143 Mass. 353 (1887), (9 N. E. Rep. 629).

*Missouri: Skrainka v. Scharrington*, 8 Mo. App. 522 (1880).

As shown in a preceding section, these associations have taken various forms.<sup>1</sup> Agreements regulating prices, restrict-

*New Jersey*: *Meredith v. Zinc & Iron Co.*, 55 N. J. Eq. 212 (1897), (37 Atl. Rep. 539); *Trenton Potteries Co. v. Olyphant*, 58 N. J. Eq. 507 (1899), (43 Atl. Rep. 723, 78 Am. St. Rep. 612, 46 L. R. A. 255).

*New York*: *Cohen v. Berlin & Jones, Env. Co.*, 38 App. Div. 499 (1899), (56 N. Y. Supp. 588).

*Rhode Island*: *Oakdale Mfg. Co. v. Garst*, 18 R. I. 484 (1894), (28 Atl. Rep. 973, 49 Am. St. Rep. 784, 23 L. R. A. 639).

*Canada*: *Ontario Salt Co. v. Merchants Salt Co.*, 18 Grant's Ch. 540 (1871).

· II. *Cases holding associations of competing manufacturers or producers illegal*:

*Alabama*: *Tuscaloosa Ice Mfg. Co. v. Williams*, 28 So. Rep. 669 (1900).

*California*: *Santa Clara Valley Mill, etc. Co. v. Hayes*, 76 Cal. 387 (1888), (18 Pac. Rep. 391, 9 Am. St. Rep. 211); *Vulcan Powder Co. v. Hercules Powder Co.*, 96 Cal. 510 (1892), (31 Pac. Rep. 581, 31 Am. St. Rep. 242).

*Michigan*: *Western Woodenware Ass'n v. Starkie*, 84 Mich. 76 (1890), (47 N. W. Rep. 604, 22 Am. St. Rep. 686, 11 L. R. A. 503).

*New York*: *De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.*, 16 Daly, 529 (1891), (14 N. Y. Supp. 277); *Cummings v. Union Blue Stone Co.*, 164 N. Y. 405 (1900), (79 Am. St. Rep. 655, 52 L. R. A. 262).

*Ohio*: *Emery v. Ohio Candle Co.*, 47 Ohio St. 320 (1890), (24 N. E. Rep. 660, 21 Am. St. Rep. 819); *Central Ohio Salt Co. v. Guthrie*, 35 Ohio St. 666 (1880); *Jackson v. Brick Ass'n*, 53 Ohio St. 303 (1895), (41 N. E. Rep. 257, 53 Am. St. Rep. 637, 35 L. R. A. 287).

*Pennsylvania*: *Nester v. Continental Brew. Co.*, 164 Pa. St. 473 (1894),

(29 Atl. Rep. 102, 44 Am. St. Rep. 624); *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173 (1871), (8 Am. Rep. 159).

*Texas*: *Texas Standard Oil Co. v. Adoue*, 83 Tex. 650 (1892), (19 S. W. Rep. 274, 29 Am. St. Rep. 690, 15 L. R. A. 598).

<sup>1</sup> See *ante*, § 308: "*Formation of Associations.*"

In addition to the cases referred to in the notes to § 308, the following recent cases illustrate different forms of associations of manufacturers and producers:

Where three coal companies which were competing in the production and sale of a particular kind of coal organized, nominally in the names of individuals, a fourth corporation to act as their general sales agent, and each corporation entered into a contract with such agent giving it the exclusive right to sell its entire output of coal at prices uniform with those of the other companies, it was held that such contract tended to suppress competition and was illegal and void.

*Slaughter v. Thacker Coal, etc. Co.*, 55 W. Va. 642 (1904), (47 S. E. Rep. 247, 104 Am. St. Rep. 1013). See also *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906), (56 S. E. Rep. 264, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268).

Where several competing corporations engaged in the business of supplying crushed granite severally entered into a contract with a corporation having a merely nominal capital, wherein each corporation agreed to sell its entire output at a stipulated price for the period of five years to the latter corporation, and further agreed, under a penalty so high as to be prohibitory, not to sell to any one else, it was held that a combination

ing production and creating selling agencies, have been, perhaps, the most common. Occasionally, novel devices have been adopted, in an attempt to avoid the effect of the decisions against combinations. Thus, an agreement was entered into by manufacturers fixing a price for their products far in excess of the market price, and stipulating that it might be reduced but not increased. It was contended that the contract, having fixed a maximum price, was not an agreement to raise prices, and, consequently, was not invalid. But it was held that the agreement, for all practical purposes, controlled prices and was illegal.<sup>1</sup>

In another instance, for the purpose of restricting production, a manufacturer was paid a bonus in the form of rent to

to prevent competition was created which was illegal at common law.

*Finck v. Schneider Granite Co.*, 187 Mo. 244 (1905), (86 S. W. Rep. 213, 106 Am. St. Rep. 452).

Where the object of a corporation was to obtain control of the compress business in certain territory by the purchase or lease of local properties and it required from vendors or lessors an agreement not to engage in the business of compressing cotton within fifty miles of any plant operated by it and to aid "in discouraging unreasonable and unnecessary competition," it was held that the execution of such a lease by a local corporation would be enjoined — the contract being void upon grounds of public policy.

*Anderson v. Shawnee Compress Co.*, 17 Okl. 231 (1906), (87 Pac. Rep. 315); *affirmed* by U. S. Supreme Court, April, 1908 (28 Sup. Ct. Rep. 572).

For cases where contracts by one corporation to sell its entire output to another corporation have been held valid, see *Heimbucher v. Goff*, 119 Ill. App. 373 (1905); *Over v. Byram Foundry Co.*, 37 Ind. App. 452 (1906), (77 N. E. Rep. 302). But *compare* *Detroit Salt Co. v. National Salt Co.*, 134 Mich. 103 (1903), (96 N. W. Rep. 1).

\* For consideration of the right of corporations to refuse to maintain trade relations with other corporations, see *Locker v. American Tobacco Co.*, 121 App. Div. (N. Y.) 443 (1907), (106 N. Y. Supp. 115).

<sup>1</sup> *National Harrow Co. v. Bement*, 21 App. Div. (N. Y.) 290 (1897), (47 N. Y. Supp. 462). The Court said: "A contract fixing the prices of harrows at more than forty per cent above their value or selling prices, and authorizing the licensor to reduce, but not to increase, the prices, as effectually controls the prices for all practical purposes as though the power to increase had been expressly reserved to the plaintiff. It would hardly be practicable to fix the prices at more than forty-three or forty-five per cent above the selling prices of the harrows."

The decision in this case was reversed by the New York Court of Appeals, 163 N. Y. 505 (1900), (57 N. E. Rep. 764), and the latter decision was affirmed by the U. S. Supreme Court, 186 U. S. 70 (1902), (22 Sup. Ct. Rep. 747). The reversal, however, was not in respect of the point stated in the text and foregoing extract.

keep his plant idle. The arrangement was held to be against public policy.<sup>1</sup>

It is, undoubtedly, the better view that a business corporation may in good faith purchase the plant of a competitor, although the effect is *pro tanto* to restrict competition; but it cannot do so as a part of a scheme, participated in by the vendor, to form a combination inimical to public policy.<sup>2</sup>

In applying the rule of public policy to combinations of manufacturers or producers the following propositions should be observed:

(1) No device can serve as a shield for an unlawful combination.

(2) An association for the restriction of competition through the regulation of prices is not necessarily unlawful.

(3) An association for the restriction of competition through the limitation of production is not necessarily unlawful.

(4) An association for the restriction of competition, either through the regulation of prices or limitation of production, becomes an association for the control of the market when the restriction becomes suppression.

(5) An association for the control of the market is an unlawful combination.

<sup>1</sup> *American, etc. Co. v. Peoria, etc. Co.*, 65 Ill. App. 502 (1895). The scheme was held invalid under an anti-trust statute, but was undoubtedly illegal without it. See also *Fox, etc. Steel Co. v. Schoen*, 77 Fed. 29 (1896). Compare *United States Chem. Co. v. Provident Chem. Co.*, 64 Fed. 964 (1894).

Where one of the two hotel proprietors in a town agreed with the other to keep his hotel closed three years and the latter agreed to pay the former a specified sum monthly during such time, it was held that the agreement was in restraint of trade, and illegal. In this case the Court adopted the somewhat unique view that a hotel is a *quasi*-public institution, the keeping open of which by the proprietor is a public duty.

*Clemons v. Meadows* (Ky. 1906), (94 S. W. Rep. 13).

<sup>2</sup> *Carter-Crume Co. v. Peurrung*, 86 Fed. 439 (1898); *Coquard v. National, etc. Co.*, 171 Ill. 480 (1898), (49 N. E. Rep. 563); *Trenton Potteries Co. v. Olyphant*, 58 N. J. Eq. 507 (1899), (43 Atl. Rep. 723, 78 Am. St. Rep. 612, 46 L. R. A. 255). Compare, however, *Lufkin Rule Co. v. Fringeli*, 57 Ohio St. 596 (1898), (49 N. E. Rep. 1030, 63 Am. St. Rep. 736, 41 L. R. A. 185); *Wittenberg v. Mollyneaux*, 60 Neb. 583 (1900), (83 N. W. Rep. 842).

This question is more fully considered in § 354, *ante*: "*Analysis of Rule governing Private Corporations. Form of Combination Immaterial.*"

§ 361. **Associations of Manufacturers owning Patents.** — The leading cases with respect to associations of manufacturers owning patents, of publishers and dealers controlling copyrights, and of manufacturers and dealers possessing secret processes have arisen under the federal anti-trust statute in connection with the examination of which the general subject is considered at length.<sup>1</sup>

Particular consideration of the application of the rules of public policy to such associations, therefore, seems unnecessary. But in applying the decisions under the federal statute it must be borne in mind that the statute goes further than the common law, and prohibits all combinations in restraint of competition whether reasonable or unreasonable. An association might violate the federal statute without infringing the rules of public policy; but the converse proposition is not true.

§ 362. **Associations of Dealers.** — In the application of the rule of public policy to associations of dealers the same principles govern as in the case of similar associations of manufacturers or producers.

Cases in which the courts have passed upon the validity of associations of dealers are collected in the footnote.<sup>2</sup>

<sup>1</sup> See *post*, § 399; "*Application of Statute to Combinations under Patents*;" § 400, "*Application of Statute to Combinations under Copyrights*"; § 401, "*Application of Statute to Combinations under Secret Processes*."

<sup>2</sup> I. *Cases holding associations of competing dealers legal*:

*Fairbanks v. Leary*, 40 Wis. 637 (1876); *Kellogg v. Larkin*, 3 Pin. (Wis.) 123 (1851), (56 Am. Dec. 164).

A live stock association organized for the protection of the interests of its members is not an illegal combination.

*Gladish v. Kansas City Live Stock Exch.* 113 Mo. App. 726 (1905), (89 S. W. Rep. 77).

II. *Cases holding associations of competing dealers illegal*:

*California*: *Pacific Factor Co. v. Adler*, 90 Cal. 110 (1891), (27 Pac. Rep. 36, 25 Am. St. Rep. 102).

*Illinois*: *Craft v. McConoughby*, 79 Ill. 346 (1875), (22 Am. Rep. 171); *Griffin v. Piper*, 55 Ill. App. 213 (1894).

*Iowa*: *Chapin v. Brown*, 83 Iowa, 156 (1891), (48 N. W. Rep. 1074, 32 Am. St. Rep. 297, 12 L. R. A. 428).

*Louisiana*: *India Bagging Association v. Kock*, 14 La. Ann. 164 (1849).

*New York*: *People v. Sheldon*, 139 N. Y. 251 (1893), (34 N. E. Rep. 785, 36 Am. St. Rep. 690, 23 L. R. A. 221); *People v. Milk Exchange*, 145 N. Y. 267 (1895), (39 N. E. Rep. 1062, 45 Am. St. Rep. 609, 27 L. R. A. 437); *Judd v. Harrington*, 139 N. Y. 105 (1893), (34 N. E. Rep. 790; *Arnot v. Pittston, etc. Coal Co.*, 68 N. Y. 558 (1877), (23 Am. Rep. 190).

In the last case the Court said: "Every producer or vendor of coal or other commodity has the right to use



§ 363. **Associations of Railroad Companies — (A) Traffic Contracts of Connecting Lines.** — A railroad company, upon principles of the common law, may make such contracts and arrangements with companies owning connecting lines, for the interchange of traffic, through rates, and through bills of lading, as it may deem expedient.<sup>1</sup> As a common carrier, it is only bound to carry on its own line, and, in the absence of statutory regulation to the contrary, may, without undue discrimination, select its own agencies for forwarding upon, or receiving freight from, other routes.<sup>2</sup> Judge Lacombe in *Prescott v. Atchison*,

all legitimate efforts to obtain the best price for the article in which he deals. But when he endeavors to artificially enhance prices by suppressing or keeping out of the market the products of others, and to accomplish that purpose by means of contracts binding them to withhold their supply, such arrangements are even more mischievous than combinations not to sell under an agreed price. Combinations of that character have been held to be against public policy and illegal."

<sup>1</sup> *United States*: *Columbus R. Co. v. Indianapolis R. Co.*, 5 McLean, 450 (1853).

*Illinois*: *Chicago, etc. R. Co. v. Ayres*, 140 Ill. 644 (1892), (30 N. E. Rep. 687).

*Minnesota*: *Stewart v. Erie, etc. Transp. Co.*, 17 Minn. 372 (1871).

*New York*: *Hartford, etc. R. Co. v. New York, etc. R. Co.*, 3 Rob. 411 (1865).

*New Jersey*: *Sussex R. Co. v. Morris, etc. R. Co.*, 19 N. J. Eq. 13 (1868); *reversed* on other grounds, 20 N. J. Eq. 542 (1869).

*Pennsylvania*: *Cumberland Valley R. Co. v. Gettysburgh, etc. R. Co.*, 177 Pa. St. 519 (1896), (35 Atl. Rep. 952).

<sup>2</sup> In *Atchison, etc. R. Co. v. Denver, etc. R. Co.*, 110 U. S. 680 (1884), (4 Sup. Ct. Rep. 185), Mr. Chief Justice Waite said: "At common law, a carrier is not bound to carry except

on his own line, and we think it quite clear that if he contracts to go beyond he may, in the absence of statutory regulations to the contrary, determine for himself what agencies he will employ. His contract is equivalent to an extension of his line for the purpose of the contract, and if he holds himself out as a carrier beyond the line, so that he may be required to carry in that way for all alike, he may nevertheless confine himself in carrying to the particular route he chooses to use. He puts himself in no worse position, by extending his route with the help of others, than he would occupy if the means of transportation employed were all his own. He certainly may select his own agencies and his own associates for doing his own work."

See also *St. Louis Drayage Co. v. Louisville, etc. R. Co.*, 65 Fed. 39 (1894); *Little Rock, etc. R. Co. v. St. Louis, etc. R. Co.*, 41 Fed. 563 (1890).

In *Eclipse Towboat Co. v. Pontchartain R. Co.*, 24 La. Ann. 1 (1872), a railroad and steamboat company, forming a through line, agreed to prorate freight from New Orleans to Mobile, and it was held that, as common carriers, in the absence of statutory prohibition, they might agree or refuse to prorate through freight with anybody, and that another steamboat company had no ground of complaint.

*etc. R. Co.*<sup>1</sup> said: "Now I know of no principle of common law which forbids an individual railroad corporation, or two or more corporations, from selecting as to which one of two or more corporations they will employ, as auxiliary to their own lines, as the agency by which they will send freight beyond their own lines, or as their agent to receive freight on the auxiliary line to be transmitted to their own line upon through bills and without breaking bulk."

The Interstate Commerce Act<sup>2</sup> and other statutes requiring carriers to furnish equal facilities for the interchange of traffic with connecting lines, and providing that there shall be no discrimination in rates and charges, do not invalidate traffic contracts for the interchange of business and relating to matters purely of mutual accommodation; nor require that such a contract, if made with one connecting carrier, shall be made with all.<sup>3</sup> If a railroad company afford equal physical facilities for the reception and delivery of freight, and maintain equal rates, it may, without contravening such statutes, discriminate in forwarding through freight, and in paying, or waiving prepayment of, charges, and may enter into traffic contracts for such purposes.<sup>4</sup>

<sup>1</sup> *Prescott, etc. R. Co. v. Atchison, etc. R. Co.*, 73 Fed. 438 (1896).

<sup>2</sup> Par. 2 of § 3 of the Interstate Commerce Act (24 U. S. Stat. at L. 380) provides: "Every common carrier subject to the provisions of this act shall, according to their respective powers, afford all reasonable, proper and equal facilities for the interchange of traffic between their respective lines, and for the receiving, forwarding, and delivering of passengers and property to and from their several lines, and those connecting therewith, and shall not discriminate in their rates and charges between such connecting lines; but this shall not be construed as requiring any such common carrier to give the use of its tracks or terminal facilities to another carrier engaged in like business."

<sup>3</sup> *Gulf, etc. R. Co. v. Miami Steamship Co.*, 86 Fed. 407 (1898); *Pres-*

*cott, etc. R. Co. v. Atchison, etc. R. Co.*, 73 Fed. 438 (1896), (practically *overruling* the decision of the same court in *New York, etc. R. Co. v. New York, etc. R. Co.*, 50 Fed. 867 (1892)); *Little Rock, etc. R. Co. v. St. Louis, etc. R. Co.*, 63 Fed. 775 (1894), (26 L. R. A. 192), *affirming* 59 Fed. 402 (1894); *Kentucky, etc. Bridge Co. v. Louisville, etc. R. Co.*, 37 Fed. 567 (1889), (2 L. R. A. 289). See also *Atchison, etc. R. Co. v. Denver, etc. R. Co.*, 110 U. S. 667 (1884), (4 Sup. Ct. Rep. 185), where the Supreme Court of the United States construed a provision of the Colorado Constitution similar to that of the Interstate Commerce Act above stated.

<sup>4</sup> *Southern Indiana Express Co. v. United States Exp. Co.*, 88 Fed. 659 (1898), (*affirmed* 92 Fed. 1022 (1899)): "The furnishing of equal facilities,

The question whether traffic contracts between connecting railroads are of such a character as to operate in restraint of interstate commerce in violation of the federal anti-trust law is considered in another chapter.<sup>1</sup>

§ 364. **Associations of Railroad Companies — (B) Traffic Contracts of Competing Lines.** — Traffic contracts between competing railroad companies for the establishment and maintenance of rates, and, for the restriction of competition, in the absence of statutory prohibitions, are not *necessarily*, although presumptively,<sup>2</sup> against public policy.<sup>3</sup> Such con-

without discrimination, does not require a common carrier to advance money to all other carriers on the same terms, nor to give credit for the carriage of articles of trade and commerce to all carriers because it extends credit for such services to others." Citing *Oregon Short Line, etc. R. Co. v. Northern Pacific R. Co.*, 61 Fed. 158 (1894); *Little Rock, etc. R. Co. v. St. Louis Southwestern R. Co.*, 63 Fed. 775 (1894), (26 L. R. A. 192); *Little Rock, etc. R. Co. v. St. Louis, etc. R. Co.*, 41 Fed. 559 (1890). See also *Gulf, etc. R. Co. v. Miami Steamship Co.*, 86 Fed. 407 (1898).

<sup>1</sup> *Post*, ch. XXXIX.: "*Construction and Application of Federal Statute.*"

<sup>2</sup> *Cleveland, etc. R. Co. v. Closser*, 126 Ind. 348 (1890), (26 N. E. Rep. 159, 22 Am. St. Rep. 593, 9 L. R. A. 754).

<sup>3</sup> The argument in favor of permitting competing railroad companies to enter into reasonable traffic contracts is well stated by Judge Blodgett in *Manchester, etc. R. Co. v. Concord R. Co.*, 66 N. H. 127 (1890), (20 Atl. Rep. 383, 49 Am. St. Rep. 582): "The naked question presented then is, whether all contracts between rival railway corporations which prevent competition are necessarily contrary to public-policy, and therefore *mala prohibita* and illegal in themselves. To state this question is to answer it in the negative, because it is obvious that the answer depends on circum-

stances. While, without doubt, contracts which have a direct tendency to prevent a healthy competition are detrimental to the public and, consequently, against public policy, it is equally free from doubt that when such contracts prevent an unhealthy competition, and yet furnish the public with adequate facilities at fixed and reasonable rates, they are beneficial, and in accord with sound principles of public policy. For the lessons of experience, as well as the deductions of reason, amply demonstrate that the public interest is not subserved by competition, which reduces the rate of transportation below the standard of fair compensation; and the theory which formerly obtained, that the public is benefited by unrestricted competition between railroads, has been so emphatically disproved by the results which have generally followed its adoption in practice, that the hope of any permanent relief from excessive rates through the competition of a parallel or rival road may, as a rule, be justly characterized as illusory and fallacious."

See also *Hare v. London, etc. R. Co.*, 2 Johns. & H. 103 (1861), (30 L. J. Ch. 817, 7 Jur. (N. S.) 1145), where Vice-Chancellor Wood said: "With regard to the argument against the validity of the agreement [a railroad traffic contract], I may clear the ground of one objection by saying

tracts have often resulted beneficially to the public as well as to the companies. The public interests, in the past, have not always been promoted by ruinous competition, rate-cutting and railroad bankruptcy.

The validity of a traffic contract, in the absence of a controlling statute, depends upon whether its provisions go further than is necessary to prevent unhealthy competition — whether its purpose or necessary or natural effect is to increase rates or diminish facilities. Traffic contracts affecting interstate commerce have, however, been held to come within the prohibition of the federal anti-trust act, the application of which is fully considered elsewhere.<sup>1</sup>

§ 364a. **Associations of Railroad Companies — (C) Pools.** — The nature of that form of traffic contract called a pool has already been fully described.<sup>2</sup> In England the validity of pool-

that I see nothing in the alleged injury to the public arising from the prevention of competition. . . . It is a mistaken notion that the public is benefited by putting two railway companies against each other till one is ruined, the result being at last to raise the fares to the highest possible standard."

The other side is presented in the dissenting opinion of Judge Shiras in *United States v. Trans. Missouri Freight Ass'n*, 58 Fed. 58 (1893), (24 L. R. A. 73) (quoted with approval by the Supreme Court in *s. c.* 166 U. S. 290 (1896)): "I fail to perceive the force of the argument that, because railway companies, through their own action, cause evils to themselves and the public by sudden changes or reductions in tariff rates, they must be permitted to deprive the community of the benefit of competition in securing reasonable rates for the transportation of the products of the country. Competition, free and unrestricted, is the general rule which governs all the ordinary business pursuits and transactions of life. Evils, as well as benefits, result therefrom. In the fierce heat of compe-

tition the stronger competitor may crush out the weaker, fluctuations in prices may be caused that result in wreck and disaster; yet balancing the benefits as against the evils, the law of competition remains as a controlling element in the business world. That free and unrestricted competition in the matter of railroad charges may be productive of evils does not militate against the fact that such is the law now governing the subject. No law can be enacted nor system be devised for the control of human affairs that, in its enforcement, does not produce some evil results, no matter how beneficial its general purpose may be. There are benefits and there are evils which result from the operation of the law of free competition between railway companies. The time may come when the companies will be relieved from the operation of this law, but they cannot, by combination and agreements among themselves, bring about this change."

<sup>1</sup> *Post*, § 398: "*Statute applies to Combinations of Railroads and Other Carriers.*"

<sup>2</sup> See *ante*, § 308: "*Formation of Associations.*"

ing agreements has been sustained and they are held to be valid and enforceable contracts.<sup>1</sup> In the Continental countries of Europe, also, pools are generally legalized. There are well-organized systems of pools in most of these countries, and, in some of them, the governments themselves enter into pools with respect to State and private lines.

In this country, on the other hand, while pools flourished prior to the passage of the Interstate Commerce Act<sup>2</sup> they were never recognized as valid agreements. The courts would not lend their aid to enforce them and they were considered to be against public policy.<sup>3</sup> In 1887 the Interstate Commerce Act absolutely prohibited them.<sup>4</sup>

<sup>1</sup> *Hare v. London, etc. R. Co.*, 2 Johns. & H. 80 (1861), (30 L. J. Ch. 817; 7 Jur. (N. S.) 1145). See also *Shrewsbury, etc. R. Co. v. London, etc. R. Co.*, 17 Q. B. 652 (1857), (2 Mac. & G. 324, 16 Beav. 411, 4 De Gex. M. & G. 116, 6 H. L. Cas. 113).

A pooling contract, amounting substantially to an amalgamation without legislative authority, was held invalid by Vice-Chancellor Wood in *Chatham v. Newcastle, etc. R. Co.*, 7 Week. R., 731 (1859) 5 Jur. (N. S.) 1100.

<sup>2</sup> The first important railroad pool in this country was the Chicago-Omaha pool, which was formed in 1870 by the Northwestern, the Burlington and Rock Island roads. This pool was successfully operated all through the Granger agitation, and was merged into the Western Freight Association in 1884. Another western pool was the Southwestern Rate Association, which was established in 1876, and related to traffic between Chicago and St. Louis and Mississippi River points.

An early eastern pool was organized by the anthracite coal roads in 1872 and continued in various forms for several years. In fact, prior to 1887, practically every railroad in the country which sought for competitive business was in one or more

pools. Probably the most comprehensive and effective of all was the Southern Railway and Steamship Association, which covered the southern traffic.

<sup>3</sup> In *Chicago, etc. R. Co. v. Wabash, etc. R. Co.*, 61 Fed. 998 (1894), the Court said with reference to a pooling contract: "Courts will not lend their aid to enforce the performance of a contract which is contrary to public policy or the law of the land, but will leave the parties in the plight their own illegal action has placed them."

For general consideration of the legality of pooling contracts, see *Nashua, etc. R. Co. v. Boston, etc. R. Co.*, 19 Fed. 804 (1884).

In *Central Trust Co. v. Ohio Central R. Co.*, 23 Fed. 306 (1885), it was held that when a pooling contract has been fully executed and the profits derived therefrom collected and held by a receiver of one of the companies, he will not be allowed to retain them, but will be ordered to make payment to the other party to the contract in accordance with its terms and without regard to its validity.

For consideration of pooling arrangements made by receivers, see *Missouri Pac. R. Co. v. Texas*, 30 Fed. 2 (1887).

<sup>4</sup> Section 5 of the Interstate Commerce Act provides as follows: "That

The anti-pooling clause was the outgrowth of the popular feeling that pools are designed to increase rates and have that effect. The real purpose of a pool, however, is to maintain rates, not to establish or increase them. And, as a matter of fact, rates decreased in this country when pools were most prevalent. Pools undoubtedly eliminate competition, but competition inevitably leads to the rebates and other discriminations prohibited by another clause of the Interstate Commerce Act. Competition cannot be enforced and discriminations prevented at the same time. The Act presents the anomaly of prohibiting discriminations, and at the same time of prohibiting a most effective means for preventing them. Instead of prohibiting pools they might well have been legalized and then regulated.<sup>1</sup>

§ 365. **Associations of Gas Companies and Other Quasi-public Corporations.** — The rule of public policy applicable to *quasi*-public corporations necessarily applies to all corporations of that class. An examination of the rule in reference to particular corporations or kinds of corporations, within that class, is valuable only by way of illustration.

it shall be unlawful for any common carrier subject to the provisions of this Act, to enter into any contract, agreement or combination with any other common carrier or carriers for the pooling of freights of different and competing railroads, or to divide between them the aggregate or net proceeds of the earnings of such railroads, or any portion thereof; and in any case of an agreement for the pooling of freights as aforesaid each day of its continuance shall be deemed a separate offence."

The provisions of this section do not apply to a pooling contract between a railroad company and a pipe line company for the transportation of oil.

*Independent Refiners' Ass'n v. Western New York, etc. R. Co.*, 4 Int. Com. Rep. 162 (1892).

This section does not invalidate a contract between railroad companies

owning parallel lines wherein it is agreed that neither company shall interfere with the other in constructing new lines; nor does it invalidate a contract as a whole, but only the pooling provisions in it.

*Ives v. Smith*, 55 Hun (N. Y.), 606 (1889), (8 N. Y. Supp. 46), *affirming* 19 N. Y. St. Rep. 556 (1888), (3 N. Y. Supp. 645).

<sup>1</sup> Various measures concerning pooling have been proposed during the last ten years. Some have merely removed the prohibition. Others have made pooling lawful, but have provided for the submission of the pooling agreement to the Interstate Commerce Commission. Consolidations have so largely divided the field that now it is rather late for strictly pooling legislation. Legalization of traffic agreements between railroads is, however, demanded. See *post*, § 398, *note*.

Gas companies which have acquired the right to lay their pipes in the public streets are *quasi*-public corporations, and any combination among them, the necessary or natural consequence of the operation of which will be to increase charges beyond reasonable rates or to restrict facilities, is inimical to public policy.<sup>1</sup>

<sup>1</sup> *Gibbs v. Consolidated Gas Co.*, 130 U. S. 408 (1889), (9 Sup. Ct. Rep. 553): "The supplying of illuminating gas is a business of a public nature to meet a public necessity. It is not a business like that of an ordinary corporation engaged in the manufacture of articles that may be furnished by individual effort. . . . Hence, while it is justly argued that those rules which say that a given contract is against public policy should not be arbitrarily extended so as to interfere with the freedom of contract, yet, in the instance of business of such character that it presumably cannot be restrained to any extent whatever without prejudice to the public interest, courts decline to enforce or sustain contracts, imposing such restraint, however partial, because in contravention of public policy."

*People v. Chicago Gas Trust Co.*, 130 Ill. 293 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497): "The business of manufacturing and distributing illuminating gas by means of pipes laid in the streets of a city is a business of a public character; it is the exercise of a franchise belonging to the State; the services rendered and to be rendered for such a grant are of a public nature; companies engaged in such business owe a duty to the public; any unreasonable restraint upon the performance of such duty is prejudicial to the public interest and in contravention of public policy."

See also *Chicago Gas Light, etc. Co. v. People's Gas Light, etc. Co.*, 121 Ill. 530 (1887), (13 N. E. Rep. 169, 2 Am. St. Rep. 124); *State v. Portland Natu-*

*ral Gas, etc. Co.*, 153 Ind. 483 (1899), (53 N. E. Rep. 1089, 74 Am. St. Rep. 314, 53 L. R. A. 413); *San Antonio Gas Co. v. State*, 22 Tex. Civ. App. 118 (1899), (54 S. W. Rep. 289).

Compare these decisions with that in the case of *Rafferty v. Buffalo City Gas Co.*, 37 App. Div. (N. Y.) 622 (1899), (56 N. Y. Supp. 288), where the Court, in holding that one gas company had power to make a contract to purchase stocks and bonds of a competing company, said: "It is further said that the contemplated purchase operates to effect a combination with another company for the creation of a monopoly, or the unlawful restraint of trade, or the prevention of competition in a necessary of life, contrary to the provisions of § 7 of the Stock Corporation Law. A monopoly is not constituted. No exclusive privilege or right as against individuals or corporations to manufacture or sell gas is acquired. Nor, in a more restricted use of the word 'monopoly,' is that condition brought about by force of this contract. . . . The contract of purchase here involved does not appear on its face to be in unlawful restraint of trade, nor to prevent lawful competition. The avowed and apparent purpose of it is to prevent ruinous competition. . . . A contract made to prevent or avoid destructive competition is not necessarily invalid."

A statute authorizing the consolidation of the gas companies in a city is not invalid as authorizing the creation of a monopoly.

*People v. People's Gas Light, etc. Co.*, 205 Ill. 482 (1903), (68 N. E. Rep. 950, 98 Am. St. Rep. 244).

All carrier corporations which exercise public franchises are governed, in respect of the right of association, by the same rule. It is immaterial whether they physically carry merchandise, convey messages by means of the electrical current,<sup>1</sup> or maintain a pipe line for the transportation of petroleum.<sup>2</sup>

<sup>1</sup> In *Benedict v. Western Union Tel. Co.*, 9 Abb. N. C. (N. Y.) 221 (1881), when two competing telegraph companies entered into an agreement for dividing expenses and earnings, the Court said: "In the absence of any legislation, it might be urged that such arrangements were against public policy as tending to prevent competition; but in view of the legislation which authorizes the consolidation of these corporations, the purchase and sale of their franchises, the joint construction and use of telegraph lines, all of which tend to prevent competition, it cannot be said that any such public policy is countenanced by the legislature of this State."

Compare this language with that of the New York Court of Appeals in the *Sugar Trust Case* (*People v. North River Sugar Ref'g Co.*, 121 N. Y. 582 (1890)), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33), where it was said, in substance, that a grant of authority to consolidate only countenanced consolidation according to its provisions, and was no indication of public policy in favor of combinations.

An agreement between a telegraph company and a railroad company, wherein the latter grants to the former the exclusive right to maintain a telegraph line upon its right of way, is against public policy and void. *Balti-*

*more, etc. Tel. Co. v. Western Union Tel. Co.*, 24 Fed. 319 (1884); *Western Union Tel. Co. v. Burlington, etc. R. Co.*, 11 Fed. 1 (1882); *Union Trust Co. v. Atchison, etc. R. Co.*, 8 N. Mex. 327 (1895), (43 Pac. Rep. 701); *Western Union Tel. Co. v. American Union Tel. Co.*, 65 Ga. 160 (1880), (38 Am. Rep. 781). See also *United States v. Union Pacific R. Co.*, 160 U. S. 1 (1895), (16 Sup. Ct. Rep. 190); *Western Union Tel. Co. v. Pennsylvania R. Co.*, 195 U. S. 540 (1904), (25 Sup. Ct. Rep. 133); *Georgia R., etc. Co. v. Atlantic Postal Tel. Coal Co.* Compare *Western Union Tel. Co. v. Chicago, etc. R. Co.*, 86 Ill. 246 (1877), (29 Am. Rep. 28).

<sup>2</sup> *West Virginia Transp. Co. v. Ohio River Pipe Line Co.*, 22 W. Va. 625 (1883), (46 Am. Rep. 527): "If there be any sort of business, which from its peculiar character can be restrained to no extent whatever without prejudice to the public interest, then the courts would be compelled to hold void any contract imposing any restraint, however *partial*, on this peculiar business; provided, of course, it be clearly shown that the peculiar business thus attempted to be restrained is of such a character, that any restraint upon it, however *partial*, must be regarded by the court as prejudicial to the public interest."



## CHAPTER XXXVII

## RIGHTS AND REMEDIES

- § 366. Rights and Remedies of Members of Illegal Combinations. In General.
- § 367. Rights and Remedies between Combination and its Members.
- § 368. Rights of Receivers and Assignees.
- § 369. Collateral Attack upon Combination. Remedies upon Independent Contracts.
- § 370. Rights of Creditors.
- § 371. Rights and Remedies of Stockholders of Combining Corporations.
- § 372. Remedies of State — (A) *Quo Warranto* against Corporate Combination.
- § 373. Remedies of State — (B) *Quo Warranto* against Combining Corporations.
- § 374. Remedies of State — (C) Injunction.
- § 375. Evidence.

§ 366. **Rights and Remedies of Members of Illegal Combinations. In General.** — The parties to a combination, formed in contravention of a rule of public policy, stand *in pari delicto*, and the law will not aid them in enforcing any rights based upon the unlawful contract.<sup>1</sup> A court of law or equity will take them as it finds them, and as it finds them will leave them, without assistance in any matter growing out of the illegal combination.

<sup>1</sup> *United States*: National Harrow Co. v. Hench, 84 Fed. 226 (1898).

*California*: Vulcan Powder Co. v. Hercules Powder Co., 96 Cal. 510 (1892), (31 Pac. Rep. 581, 31 Am. St. Rep. 242).

*Illinois*: Craft v. McConoughy, 79 Ill. 346 (1875), (22 Am. Rep. 171); Foss v. Cummings, 149 Ill. 353 (1894), (36 N. E. Rep. 553). See also American Strawboard Co. v. Peoria Strawboard Co., 65 Ill. App. 502 (1895).

*Iowa*: Chapin v. Brown, 83 Iowa, 156 (1891), (48 N. W. Rep. 1074, 32 Am. St. Rep. 297, 12 L. R. A. 428).

*Kansas*: Greer v. Payne, 4 Kan. App. 153 (1896), (46 Pac. Rep. 190).

*Louisiana*: Texas, etc. R. Co. v. Southern Pac. R. Co., 41 La. Ann. 970 (1889), (6 So. Rep. 888, 17 Am. St. Rep. 445); India Bagging Ass'n v. Kock, 14 La. Ann. 168 (1859).

*Missouri*: State v. Firemen's Fund Ins. Co., 152 Mo. 1 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363).

*New York*: Judd v. Harrington, 139 N. Y. 105 (1893), (34 N. E. Rep. 790); Pittsburgh Carbon Co. v. McMillan, 119 N. Y. 46 (1890), (23 N. E. Rep. 530, 7 L. R. A. 46); Leonard v. Poole, 114 N. Y. 379 (1889), (21 N. E. Rep. 707, 11 Am. St. Rep. 667, 4 L. R. A. 728); Gray v. Oxnard Bros. Co., 39 Hun. 387 (1891), (13 N. Y. Supp. 86); Clancy v. Onondaga Fine Salt

In the application of the maxim *ex turpi causa non oritur actio*, the test is whether the plaintiff is obliged to rely upon the illegal contract in order to establish his right to relief.<sup>1</sup> If he claims through the medium of an unlawful transaction, he is without standing, for the courts will not assist in adjusting differences growing out of, or requiring the investigation of, illegal transactions, however much they may be disguised.

Upon these principles, a member of an illegal combination cannot maintain an action to recover his share of the profits of the enterprise,<sup>2</sup> or for an accounting;<sup>3</sup> nor can he obtain redress for a fraud committed by another member in carrying out the combination agreement.<sup>4</sup> He is not only without

Mfg. Co., 62 Barb. 395 (1862); *De Witt Wire Cloth Co. v. New Jersey Wire Cloth Co.*, 16 Daly, 529 (1891), (14 N. Y. Supp. 277).

*Ohio*: *Emery v. Ohio Candle Co.*, 47 Ohio St. 320 (1890), (24 N. E. Rep. 660, 21 Am. St. Rep. 819).

*Pennsylvania*: *Nester v. Continental Brewing Co.*, 161 Pa. St. 473 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894); *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173 (1871), (8 Am. Rep. 159).

<sup>1</sup> *Greer v. Payne*, 4 Kan. App. 162 (1896), (46 Pac. Rep. 190): "The contract of membership is, therefore, illegal and void, and no right can grow out of it. Hence, it comes to this: A court of equity is asked to assist the plaintiffs in carrying out an illegal contract, so that they may enjoy its fruits, and to aid them in maintaining a position as members of an organization, which can be done only by a continual violation of the law. This will not be done. The law will not allow any effect to an illegal contract either by enforcing it or by aiding one to secure benefits accruing from it. Whenever it is necessary for a plaintiff to establish or rely upon an illegal contract as a basis of his right to relief, the courts will not stop to inquire into the

merits of the controversy, but will at once refuse to exercise their jurisdiction in his behalf."

See also *Nester v. Continental Brewing Co.*, 161 Pa. St. 473 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894). The *Charles E. Wiswall*, 86 Fed. 671 (1898); *Getz Bros. & Co. v. Federal Salt Co.*, 147 Cal. 115 (1905), (81 Pac. Rep. 416, 109 Am. St. Rep. 114).

<sup>2</sup> *Emery v. Ohio Candle Co.*, 47 Ohio St. 320 (1890), (24 N. E. Rep. 660, 21 Am. St. Rep. 849); *Foss v. Cummings*, 149 Ill. 353 (1894), (36 N. E. Rep. 553); *Gray v. Oxnard Bros. Co.*, 59 Hun (N. Y.), 387 (1891), (13 N. Y. Supp. 86). See also *Meyers v. Merilion*, 118 Cal. 352 (1897), (50 Pac. Rep. 662).

<sup>3</sup> *Nester v. Continental Brewing Co.*, 161 Pa. St. 473 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894); *Leonard v. Poole*, 114 N. Y. 379 (1889), (21 N. E. Rep. 707, 11 Am. St. Rep. 667, 4 L. R. A. 728).

<sup>4</sup> *Leonard v. Poole*, 114 N. Y. 379 (1889), (21 N. E. Rep. 707, 11 Am. St. Rep. 667, 4 L. R. A. 728): "The relief sought would require the court to investigate all of the various transactions of these parties, from the beginning to the end of their unlawful enterprise, and adjust the differences between them. This is precisely what

remedy upon the agreement respecting the combination, but he cannot recover for the breach of *any* contract made in furtherance of its objects.<sup>1</sup> If follows, also, that a court of equity will afford him no relief, by injunction or otherwise, for the enforcement or protection of his rights as a member of an unlawful combination.<sup>2</sup>

§ 367. **Rights and Remedies between Combination and its Members.**—An agreement for a combination contrary to public policy is invalid; the resultant organization — association, trust or corporate combination — is unlawful. Courts of law or equity will not lend such a combination aid in the enforcement of the invalid agreement or in any matter adhering thereto. If the contracts between the combination and its members are executory, a court will not enforce them in favor of or against the combination; if fully executed, a court will not attempt to rescind them at the suit of either party, or grant other relief.<sup>3</sup> Both the combination and its members will be

courts have always refused to do. The fraud which the trial court found was practised by these defendants upon their associate cannot be too strongly condemned, but courts are not organized to enforce the saying that there is honor among law-breakers, and the desire to punish must not lead to a decision establishing the doctrine that law-breakers are entitled to the aid of courts to adjust differences arising out of, and requiring an investigation of, their illegal transactions."

It affords no ground for enforcing an illegal agreement that the defendant is more culpable than the plaintiff.

*Detroit Salt Co. v. National Salt Co.*, 134 Mich. 103 (1903), (96 N. W. Rep. 1).

<sup>1</sup> Where a contract for the sale of grain bags provided that the purchaser should have the exclusive right to sell such bags up to a prescribed number and for the sale of a lesser number *pro rata*, and such contract was a part of a scheme to gain a monopoly, it was held that the contract was void

and that there could be no recovery for a breach thereof.

*Pacific Factor Co. v. Adler*, 90 Cal. 110 (1891), (27 Pac. Rep. 36, 25 Am. St. Rep. 102). See also *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173 (1871), (8 Am. St. Rep. 159); *Beechley v. Mulville*, 102 Iowa, 602 (1897), (70 N. W. Rep. 107, 63 Am. St. Rep. 479).

<sup>2</sup> *Greer v. Payne*, 4 Kan. App. 153 (1896), (46 Pac. Rep. 190). See also next section.

<sup>3</sup> *Queen Ins. Co. v. State*, 86 Tex. 250 (1893), (24 S. W. Rep. 397, 22 L. R. A. 491).

See also *Richardson v. Buhl*, 77 Mich. 661 (1889), (43 N. W. Rep. 1102, 6 L. R. A. 457), where the Court (*per* Champlin, J.) said: "It is also well settled that, if a contract be void as against public policy, the court will neither enforce it while executory, nor relieve a party from loss by having performed it in part." Citing *Foote v. Emerson*, 10 Vt. 344 (1838), (33 Am. Dec. 205); *Hanson v. Power*, 8 Dana (Ky.), 91 (1839);

left where they have placed themselves. Thus, a corporate combination cannot maintain an action of replevin for property purchased in the formation of the combination but which has remained in the possession of the vendor; <sup>1</sup> nor sue for a receiver and an accounting when a member withdraws.<sup>2</sup> Nor will a bill for an injunction lie to prevent a member from doing business contrary to the provisions of the combination agreement, even though it retain the consideration paid.<sup>3</sup>

It has, however, been held that a member, seeking to withdraw from an illegal combination and returning the considera-

Pratt v. Adams, 7 Paige (N. Y.), 616 (1839); Piatt v. Oliver, 1 McLean (U. S.), 294 (1837); 2 McClean (U. S.), 277 (1840); Stanton v. Allen, 5 Denio (N. Y.), 434 (1848), (49 Am. Dec. 282). In Hutchins v. Weldon, 114 Ind. 89 (1887), (15 N. E. Rep. 804), the Supreme Court of Indiana said: "The law in such case will leave the parties just where it finds them. If the contract has not been executed, the law will not extend relief. When a contract, void as against sound morals or public policy, has been fully executed by both parties and suit brought under, upon or against such contract, *potior est conditio defendantis*."

<sup>1</sup> Bishop v. American Preservers Co., 157 Ill. 316 (1895), (41 N. E. Rep. 765, 48 Am. St. Rep. 317): "In the case at bar, the appellant never parted with the possession of the property. After he executed the bill of sale, he still continued his business the same as before, though subject to the orders and direction of the trust. The beginning of the action of replevin admits his possession, as replevin does not lie against one not in possession. Wells on Replevin, 77; Hall v. White, 106 Mass. 599 (1871). We see no reason why the doctrine of the Kirkpatrick Case does not apply here, although the action is replevin and not ejectment, and although the property involved is personalty and not real

estate. The bill of sale rests under the ban of the law, as well when executed to carry out the illegal agreement hereinbefore set forth, as if it had been made for the purpose of defrauding creditors. The law will not aid the appellee to recover the property, but will leave both it and appellant where they were when the suit was begun."

<sup>2</sup> American Biscuit, etc. Co. v. Klotz, 44 Fed. 721 (1891).

<sup>3</sup> American Preservers Trust v. Taylor Mfg. Co., 46 Fed. 152 (1891): "The ultimate question is whether the covenant to discontinue one branch of its business, made under the circumstances and for the considerations disclosed by the bill, can be enforced in equity against the defendant corporation. An injunction as prayed for, if granted, will operate, of course, as a specific enforcement of the covenant; and the general rule is that agreements will not be specifically enforced that are inequitable, or tainted with illegality, or that are in excess of corporate powers. . . . In view of the unlawful character of the transaction out of which the covenant arises, I conclude that a court of equity would not be warranted in enforcing it by injunction, even though the defendant company has received, and still retains, a portion of the consideration which induced it to execute the covenant."

tion paid, is entitled to an injunction restraining the combination from taking possession of its property, and to a decree declaring the combination agreement void.<sup>1</sup>

An agreement contrary to a rule of public policy, in its effect upon the rights of the parties, must be distinguished from an *ultra vires* agreement. Property delivered to a combination which is, in its formation, merely beyond the powers of the corporations composing it, may be recovered back;<sup>2</sup> while no relief will be granted to a party to an agreement inimical to public policy. The distinction is between invalidity and unlawfulness.

§ 368. **Rights of Receivers and Assignees.** — As a general rule, a receiver takes the title of the corporation which he represents, and any defences which would have been good against it are good against him. Thus, a receiver appointed in proceedings to forfeit the charter of a corporation on account of its participation in an illegal combination, cannot maintain an action against another member of the combination to recover a share of the profits accruing from the unlawful enterprise.<sup>3</sup>

<sup>1</sup> *Merz Capsule Co. v. United States Capsule Co.*, 67 Fed. 414 (1895): "It remains to be considered what relief should be administered upon this state of things. The proof sufficiently shows — and, indeed, the nature of the transaction sufficiently demonstrated this — that the complainant on its own account is not entitled to claim any relief founded upon the contract; but the contract itself being contrary to law, furnishes no support for the aggressive attitude and conduct of the defendants. The complainant's conduct has been disingenuous, but I think it has the law of the case. The result is, as it seems to me, that the parties stand, in respect of their property rights, upon the same footing as if the contract had never been made; and, upon the restoration by the complainant of what it has received upon the footing of the contract, it would seem that the complainant is entitled to preventive relief, and that the defendants,

or such of them as threaten to invade the property of the complainant, should be restrained from interfering therewith."

<sup>2</sup> *Mallory v. Hanaur Oil Works*, 86 Tenn. 598 (1888), (8 S. W. Rep. 396). In this case five companies engaged in the manufacture of cotton seed oil formed a trust and turned over their mills to an executive committee, and they were operated by such committee. One of the corporations voted to withdraw, and brought an action of unlawful detainer for the recovery of its property. The trust agreement was held invalid as involving an *ultra vires* partnership of corporations and the plaintiff was allowed a recovery. No question appears to have been raised as to the legality of the combination upon considerations of public policy.

<sup>3</sup> *Gray v. Oxnard Bros. Co.*, 59 Hun (N. Y.), 387 (1891), (13 N. Y. Supp. 86).

Upon similar principles, an assignee of a party to an illegal combination stands in the shoes of his assignor and takes the assigned claim subject to all disabilities attaching to it.<sup>1</sup>

An exception to the general rule that defences good against a corporation are available against its receiver exists where the corporation is insolvent. Thus, the receiver of an insolvent corporate combination may collect debts due it, and apply them in satisfaction of the claims of creditors, even though the defence of illegality might have been available if the action had been brought by the combination.<sup>2</sup> It is manifest, however, that this exception applies only to collateral agreements. A receiver, even of an insolvent corporation, could not maintain an action *based upon* an unlawful contract.

§ 369. **Collateral Attack upon Combination. Remedies upon Independent Contracts.** — The due and regular administration of justice requires that the validity of combinations, — trusts, corporate combinations or associations, — according to the rules of public policy, should be determined in direct proceedings instituted for the purpose; or in actions based upon, or growing out of, the alleged illegal contract. The mere fact that the general object of a corporation is opposed to public policy — that it constitutes an unlawful combination — does not serve *ipso facto* to create a default upon its obliga-

<sup>1</sup> *Nester v. Continental Brewing Co.*, 161 Pa. St. 473 (1894), (29 Atl. Rep. 102, 41 Am. St. Rep. 894).

<sup>2</sup> *Pittsburgh Carbon Co. v. McMillan*, 119 N. Y. 46 (1890), (23 N. E. Rep. 530, 7 L. R. A. 46): "The general rule is well established that a receiver takes the title of the corporation or individual whose receiver he is, and that any defence which would have been good against the former may be asserted against the latter. But there is a recognized exception which permits a receiver of an insolvent individual or corporation, in the interest of creditors, to disaffirm dealings of the debtor in fraud of their rights. Assuming that the trustee could not have recovered of the debtor for the reason suggested, it would be a

very strange application of the doctrine that no right of action can spring from an illegal transaction, which should deny to innocent creditors of the combination, or to the receiver who represents them, the right to have the debt collected and applied in satisfaction of their claim. The just rule of the common law, that courts will not lend their aid to enforce illegal transactions at the instance of a party to the illegality, would be misapplied if permitted to be used to prevent the application of the fund in question to the payment of creditors of the combination."

See also *American Handle Co. v. Standard Handle Co.* (Tenn. 1900), 59 S. W. Rep. 709.

tions nor to deprive it of standing to protect its rights; and such fact cannot be invoked collaterally to affect in any manner its *independent* rights or obligations.<sup>1</sup>

The rule for determining the independent character of a

<sup>1</sup> *Dennehy v. McNulta*, 86 Fed. 825 (1898), (41 L. R. A. 609); *Lafayette Bridge Co. v. City of Streator*, 105 Fed. 731 (1900); *Olmstead v. Distilling, etc. Co.*, 73 Fed. 49 (1895).

In *Liverpool, etc. Ins. Co. v. Clunie*, 88 Fed. 169 (1898), the Court said: "It is further objected by the defendant that the complainants should not be allowed to come into a court of equity for relief; and, in support of this objection, he invokes the maxim that he who comes into a court of equity must do so with clean hands. The inequitable conduct charged against the complainants is that they are members of an illegal combination . . . ; that the main purpose of this association is to prevent and suppress competition in the insurance business of this State, to control the fixing of premium rates to be charged on insurance, to regulate and prevent rebates, to fix compensation for insurance, to regulate premium collections, and to appoint agencies; that seven-eighths of the insurance companies authorized to transact business in the State are members of this confederation. . . . It will not be necessary to enter into a discussion of the facts thus presented for the purpose of determining the legality of the Board of Underwriters in this action, or to ascertain how far its acts are opened to just criticism. It is manifest that, if such a controversy is disclosed, it is foreign to the one now before the court. The maxim that he who comes into equity must come with clean hands has its limitations. It does not apply to every unconscientious or inequitable conduct on the part of the complainants. The

inequity which deprives a suitor of a right to justice in a court of equity is not general iniquitous conduct unconnected with the act of the defendant which the complaining party states as his ground or cause of action, but it must be evil practice or wrong conduct in the particular matter or transaction in respect to which judicial protection or redress is sought."

The objection that a corporation is an unlawful combination cannot be made by a party who has entered into a contract with it wholly independent of its alleged illegal purpose.

*Harrison v. Glucose Sugar Refg. Co.*, 116 Fed. 304 (1902), (58 L. R. A. 915).

The question whether an association of railroad companies amounts to an unlawful combination cannot be determined in an action to enjoin the sale of non-transferable tickets issued by one of the members of such association.

*Kinner v. Lake Shore, etc. R. Co.*, 23 Ohio Cir. Ct. Rep. 294 (1902).

A person who has entered into a combination agreement contrary to public policy may, upon repudiating it, enforce a cause of action existing independently of it. The maxim *in pari delicto* is inapplicable under such circumstances.

*Brennan v. United Hatters*, 73 N. J. 729 (1906), (65 Atl. Rep. 165, 118 Am. St. Rep. 727).

See also *National Distilling Co. v. Cream City Importing Co.*, 86 Wis. 356 (1893), (56 N. W. Rep. 864, 39 Am. St. Rep. 902); *Anheuser-Busch Brewing Ass'n v. Houck* (Tex. 1894), 27 S. W. Rep. 692; *Arnot v. Pittston, etc. Coal Co.*, 68 N. Y. 558 (1877), (23 Am. Rep. 190).

demand is clearly stated by Judge Lacombe in the case of *The Charles E. Wiswall*:<sup>1</sup> "The test, whether a demand connected with an illegal transaction is capable of being enforced at law, is whether the plaintiff requires the aid of the illegal transaction to establish his case. If he cannot open his case, without showing that he has broken the law, a court will not assist him. But if he does not claim through the medium of the illegal transaction, but upon a new contract bottomed on an independent consideration, he may recover."<sup>2</sup>

The sale of goods by a combination to a purchaser, in the course of its business, is not connected with the illegal character of the combination, but is based upon an essentially different consideration. It is an independent contract, and the purchaser cannot avoid his contract obligation by setting up the invalidity of the plaintiff combination.<sup>3</sup> Upon simi-

<sup>1</sup> *The Charles E. Wiswall*, 86 Fed. 674 (1898).

<sup>2</sup> Citing *Swan v. Scott*, 11 Serg. & R. 155 (1824); *Armstrong v. Toler*, 11 Wheat. (U. S.) 258 (1826); *McBlair v. Gibbs*, 17 How. (U. S.) 236 (1854).

<sup>3</sup> In *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 545 (1902), (22 Sup. Ct. Rep. 431), the Supreme Court of the United States said: "Assuming, as defendants contend, that the alleged combination was illegal if tested by the principles of the common law, still it would not follow that they could, at common law, refuse to pay for pipe bought by them under special contracts with the plaintiff. The illegality of such combination did not prevent the plaintiff corporation from selling pipe that it obtained from its constituent companies, or either of them. It could pass title by a sale to any one desiring to buy, and the buyer could not justify a refusal to pay for what he bought and received by proving that the seller had previously, in the prosecution of its business, entered into an illegal combination with others in reference generally to the sale of Akron pipe.

(p. 549). This is not an action to enforce, or which involves the enforcement of, the alleged arrangement or combination between the plaintiff corporation and other corporations, firms and companies in relation to the sale of Akron pipe. As already suggested, the plaintiff, even if part of a combination illegal at common law, was not, for that reason, forbidden to sell property it acquired or held for sale. The purchases by the defendants had no necessary or direct connection with the alleged illegal combination; for the contracts between the defendants and the plaintiff could have been proven without any reference to the arrangement whereby the latter became an illegal combination. If, according to the principles of common law, the Union Sewer Pipe Company could not have sold or passed title to any pipe it received and held for sale, because of an illegal arrangement previously made with other corporations, firms or companies, a different question would be presented. But we are aware of no decision to the effect that a sale similar to that made by the present plaintiff to the defendants respectively would, in itself,



lar principles, an insurance company cannot escape responsibility upon its contract of insurance by alleging that the plaintiff has joined an unlawful combination;<sup>1</sup> and infringers of patents cannot evade liability for their own wrongs by pleading that the plaintiff has entered into a combination to control the market for the patented article.<sup>2</sup>

The principles stated in this section are, however, materially modified in the anti-trust statutes of many States, which expressly provide that the illegality of a combination may be pleaded as a defence to suits upon its independent contracts.<sup>3</sup>

be illegal and void under the principles of the common law."

And in *National Distilling Co. v. Cream City Importing Co.*, 86 Wis. 356 (1893), (56 N. W. Rep. 864, 39 Am. St. Rep. 902), the Supreme Court of Wisconsin said: "The argument, if any the case admits of, is that, as the plaintiff was a member of the so-called 'trust' or 'combination,' the defendant might voluntarily purchase the goods in question of it at an agreed price, and convert them to its own use, and be justified in a court of justice in its refusal to pay the plaintiff for them, because of the connection of the vendor with such trust or combination. The plaintiff's cause of action is, in no legal sense, dependent upon or affected by the alleged illegality of the trust or combination, because the illegality, if any, is entirely collateral to the transaction in question, and the court is not called upon, in this action, to enforce any contract tainted with illegality, or contrary to public policy. The mere fact that the plaintiff is a member of a trust or combination, created with the intent and for the purposes set forth in the answer, will not disable or prevent it at law from selling goods, and recovering their price or value."

A sale and conveyance of its assets and good-will by one corporation to another cannot be repudiated by the

purchaser upon the ground that the vendor acquired the property sold with the object of forming an unlawful combination.

*Metcalf v. American School Furniture Co.*, 122 Fed. 115 (1903).

See also *Wiley v. National Wall Paper Co.*, 70 Ill. App. 543 (1896); *Chicago Wall Paper Mills v. General Paper Co.*, 147 Fed. 491 (1906).

<sup>1</sup> *Springfield Fire, etc. Ins. Co. v. Cannon* (Tex. Civ. App. 1898), 46 S. W. Rep. 376: "The evidence in the case hardly raises the question, but we are of the opinion that, even if it did, it would not prevent the owner of the bagging from insuring it, although he may have been a member of a trust with respect to controlling the prices of bagging in the State of Texas."

<sup>2</sup> *National Folding Box, etc. Co. v. Robertson*, 99 Fed. 985 (1900); *Bonsack Mach. Co. v. Smith*, 70 Fed. 383 (1895); *American Soda Fountain Co. v. Green*, 69 Fed. 333 (1895); *Edison Electric Light Co. v. Sawyer-Man Electric Co.*, 53 Fed. 592 (1892); *Strait v. National Harrow Co.*, 51 Fed. 819 (1892); *Columbia Wire Co. v. Freeman Wire Co.*, 71 Fed. 306 (1895); *Contra, National Harrow Co. v. Quick*, 67 Fed. 130 (1895).

<sup>3</sup> See *post*, ch. XLIII.: "*Rights, Remedies and Procedure under State Anti Trust Statutes.*"

§ 370. **Rights of Creditors.** — The legality of a combination cannot be made the subject of collateral attack in enforcing its independent demands. *A fortiori*, the combination cannot, itself, set up its illegality as a defence to demands against it. It cannot take advantage of its own wrong-doing. That a combination is unlawful, tested by the rule of public policy, is no defence to actions by its creditors.<sup>1</sup>

The fact that the creditor knew the character of the combination when the debt was incurred, does not affect his right to recover, unless he in some way participated in the illegal project. In *Arnot v. Pittston, etc. Coal Co.*,<sup>2</sup> the Court of Appeals of New York said: "He had a right to dispose of his own goods, and (under certain limitations) a vendor of goods may recover for their price, notwithstanding that he knows that the vendee intends an improper use of them, so long as he does nothing to aid in such improper use, or in the illegal plans of the purchaser. This doctrine is established by authority, and is sufficiently liberal to vendors. But — and this is a very important distinction — if the vendor does anything beyond making the sale, to aid the illegal scheme of the vendee, he renders himself *particeps criminis*, and cannot recover for the price."

An agreement for the sale of all its products, entered into by a manufacturing company, in good faith, and in ignorance of any ulterior purpose on the part of the purchaser, is not rendered unenforceable by the fact that the latter has made similar contracts with other manufacturers — each in ignorance of the other — for the purpose of controlling the market for the commodity.<sup>3</sup>

<sup>1</sup> *Globe Tobacco Warehouse Co. v. Leach*, 19 Ky. L. Rep. 1287 (1897), (43 S. W. Rep. 423); *Pittsburgh Carbon Co. v. McMillan*, 119 N. Y. 46 (1890), (23 N. E. Rep. 520, 7 L. R. A. 46); *Arnot v. Pittston, etc. Coal Co.*, 68 N. Y. 558 (1877), (23 Am. Rep. 190); *Catskill Bank v. Gray*, 14 Barb. (N. Y.) 479 (1851).

<sup>2</sup> *Arnot v. Pittston, etc. Coal Co.*, 68 N. Y. 558 (1877), (23 Am. Rep. 190).

<sup>3</sup> In *Carter-Crume Co. v. Peurrung*, 86 Fed. 439 (1898), Judge Lurton said: "Another question might arise if all or a large proportion of all the producers of a particular article should agree to sell their entire product to one buyer, who would thereby be enabled to monopolize the market. But if each independent producer contract to sell his product or to sell or lease his plant, without concert with others, or knowledge of or pur-

§ 371. **Rights and Remedies of Stockholders of Combining Corporations.** — An unlawful act is an *ultra vires* act. A corporation has no legal power to enter a combination against public policy. Equity will enjoin the formation or continued operation of an illegal combination, at the instance of any stockholder of a constituent corporation<sup>1</sup> who has not participated in the illegal scheme and who acts with diligence.<sup>2</sup>

pose to participate in the plans of the buyer, he cannot be said to have conspired against freedom of commerce, or to have made a contract in illegal restraint of trade. . . . The proof must show that the illegal purpose was mutual."

<sup>1</sup> In *Stewart v. Erie, etc. Transp. Co.*, 17 Minn. 395 (1871), the Supreme Court of Minnesota said: "We agree with the plaintiff's counsel, and with the cases by him cited, that it is against the general policy of the law to destroy or interfere with free competition. . . . An unauthorized monopoly is, therefore, against public policy as destroying or interfering with free competition. . . . (p. 398). If a corporation is employing its statutory powers, funds, etc. for purposes not within the scope of its institution, a court of equity will, upon the application of a single dissentient stockholder, interfere by injunction. . . . The right of a stockholder to this interference seems to be placed upon the ground that, from the fact that the corporation was created for *certain* purposes there is an implied contract that it shall not divert its powers or funds to *other* purposes, and that such diversion would be a species of breach of trust . . . as well as a violation of law which might endanger the existence of its charter. But it is to a *dissentient* stockholder that the relief is granted, and to a stockholder who comes with *diligence* to assert his rights."

See also *Harding v. American Glucose Co.*, 182 Ill. 551 (1899), (55 N.

E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738); *Leslie v. Lorillard*, 110 N. Y. 519 (1888), (18 N. E. Rep. 363, 1 L. R. A. 456); *Central R. Co. v. Collins*, 40 Ga. 582 (1869). See also *ante*, § 46: "*Rights and Remedies of Dissenting Stockholders*" (consolidation); *ante*, § 114: "*Remedies of Dissenting Stockholders in Case of Invalid or Unfair Sales*"; *ante*, § 151: "*Rights and Remedies of Dissenting Stockholders*" (sales of railroads); *ante*, § 191: "*Remedies of Dissenting Stockholders*" (leases); *ante*, § 293: "*Remedies in Case of Ultra Vires Stockholding*."

<sup>2</sup> *Levin v. Chicago Gas Light, etc. Co.*, 64 Ill. App. 400 (1896): "He alleges that he acquired the certificate without knowledge that the same was tainted with any conspiracy or combination; but that is not enough. . . . Every inference deducible from his bill is, that he not only knew of, but participated in, all that he complained of. One who has participated in illegal acts and conspiracies, and partaken of the fruits thereof, may not tear down the structure he has helped to rear simply because he did not know that he had been engaged in illegality and conspiracy. . . . (p. 402). To entitle stockholders to the summary interference of a court, they must apply so recently after the doing of the acts complained of that the court may stop or undo the wrong to them without doing equal or greater wrong to some other person; or, in other words, if a stockholder wants protection against the consequences

It has been contended that the illegality of a corporate combination is the illegality of *that* corporation; that stockholders of a vendor corporation can maintain a bill for an injunction only when their pecuniary interests are affected, and not for the protection of the general public, and, consequently, that they are without standing to complain of the unlawful character of the purchasing corporation. The defect of the argument is in its assumptions. The pecuniary interests of a stockholder of a vendor corporation *are* affected by a transfer of its property to an illegal combination. The combination, if carried out, may lead to a forfeiture of the charter of the vendor corporation, and consequent loss of the stockholder's shares. Moreover, the pecuniary *status* of a stockholder is changed by the transfer of the property and business of his corporation to another corporation, although he may receive his share of the proceeds. He has the right to object to such a change in the form of his investment, especially where the proceeds of the sale are tainted with the illegality of the combination.<sup>1</sup>

of an *ultra vires* act, he must ask for it with sufficient promptness to enable the court to do justice to him without doing injustice to others."

See also *Coquard v. National Linseed Oil Co.*, 171 Ill. 480 (1898), (49 N. E. Rep. 563); *Stewart v. Erie, etc. Transp. Co.*, 17 Minn. 395 (1871). See also *ante*, § 49: "*Laches of Stockholders*" (consolidation); *ante*, § 116: "*Defences to Stockholders' Actions. Estoppel*" (sales); § 192: "*Acquiescence and Laches of Stockholders*" (leases).

<sup>1</sup> In *Harding v. American Glucose Co.*, 182 Ill. 625 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738), the Supreme Court of Illinois said: "The position of counsel is that a stockholder can only file a bill to prevent the corporation from disposing of its properties, upon the ground that it will affect his pecuniary interests and because of the necessity of protecting his property rights and because of the necessity of protecting

himself from pecuniary loss or injury; and that a stockholder in a vendor corporation has no right to enjoin a sale and transfer of a factory, owned by such vendor, upon the ground that the vendee corporation proposes to create a monopoly. . . . It is idle to say that a stockholder in a corporation would suffer no injury from a forfeiture of its charter rights and from its dissolution. In such a case, the corporation being destroyed, his stock therein would be completely wiped out and be made of no effect. The stockholder has a right to protest against such use of its property by the managing officers of a corporation as will lead to such forfeiture and dissolution. . . . (p. 628). What was there attempted was an abandonment of the business and sale of the assets without legal termination or dissolution of the company. It makes no difference that the stockholder is to be allowed to receive his proportionate share of the proceeds of the sale of the

A stockholder may maintain a bill in his own name against the corporation and its officers, whenever it is reasonably certain that a demand upon the officers to bring the suit in the name of the corporation would be unavailing.<sup>1</sup>

property. He has a right to hold his investment in the form of stock, and a change of such investment against his consent is a change which affects his pecuniary or financial interests. He has the right to be the judge whether such change in his pecuniary *status* shall be made or whether he shall continue his investment in the form of stock."

*Compare*, however, *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 446 (1903), (75 Pac. Rep. 89), where the Supreme Court of Montana said: "The plaintiff sues as a private citizen. He is not as such authorized to present, through the medium of a civil action, and try the issue whether the defendant Amalgamated Company is doing business in this State in violation of law. A determination of this issue as an independent ground of relief must be had, if at all, by the State, and in its own behalf through the attorney-general. It is no concern of the plaintiff if the State neglects or waives its right to call the defendant to account. In general the same may be said as to the issue whether the combination formed by the defendant Amalgamated Company through its officers and the stockholders of the Montana Company and other corporations is a monopoly in violation of the Penal Code of the State, rendered the defendant Montana Company liable to punishment and a forfeiture of its franchises and property. . . Nor do we know any provision of law authorizing a court of equity, at the instance of a minority stockholder, to decree a forfeiture of the stock of any stockholder in the same corporation to the corporation, on the ground that the title of such stockholder has been acquired and is

held in violation of the charter of the corporation. Nevertheless, so far as the participation of the Montana corporation and its officers in an unlawful combination to create a monopoly subjects its property and franchises to a forfeiture and thus imperils the property rights of the minority stockholder he has a cause of complaint against it and them, and may, through the medium of a court of equity, compel it and them to abandon such unlawful connection and return to a performance of their obligations under the charter contract of the company, to wit: to accomplish, through its board of directors, the purpose for which it was formed, and by lawful means."

In *Dittman v. Distilling Co.*, 64 N. J. (Eq. 537 (1903), 54 Atl. Rep. 570), where it was charged that a corporation had created a monopoly and it appeared that such monopoly, if it existed, arose from the exercise by the corporation of the power conferred by its charter to purchase the shares of other corporations, the vice-chancellor held that the question of a monopoly could not be determined by a court of equity in a suit by a stockholder, and could only be considered in *quo warranto* proceedings instituted by the attorney-general to oust the corporation from its franchises.

<sup>1</sup> In *Harding v. American Glucose Co.*, 182 Ill. 628 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738), the Court further said: "The bill in this case recites that the complainants therein filed it, not only in their own behalf, but in behalf of all other stockholders, who might see fit to come into the suit and join therein. Where the officers of a corporation wrongfully deal with its

Foreign corporations are subject to the same rules of public policy, within the State, as domestic companies. A court of equity will grant relief, touching property within the State, to a stockholder of a foreign corporation which is participating in an unlawful combination.<sup>1</sup>

§ 372. Remedies of State — (A) Quo Warranto against Corporate Combination. — The scope of the remedy of *quo warranto* — applied to corporations — is the forfeiture of the franchises of a corporation for non-user or misuser. The object of the writ is the protection of the public and not the redress of private wrongs. In order to secure a judgment of ouster, misuser must be shown working or threatening injury to the

property to the injury of the stockholders, the latter may maintain a bill against the company and its officers for relief against such misappropriations. Originally, the rule was that such a suit should be brought by the corporation itself; but equity permits a stockholder, either individually or in behalf of other stockholders similarly situated, to bring such a suit, where the corporation itself either refuses to do so, or where the facts show that the wrong-doing defendants constitute a majority of the managing body, or where it is reasonably certain that a demand made upon the proper officers of the corporation to bring the action would be unavailing."

See also *ante*, § 48: "*Procedure in Stockholders' Actions*" (consolidation); *ante*, § 115: "*Procedure in Stockholders' Actions*" (sales).

<sup>1</sup> In *Harding v. American Glucose Co.*, 132 Ill. 635 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738) the Court also said: "It is the settled doctrine of this State, established by many decisions of this court, that foreign corporations do not come into this State as a matter of legal right, but only by comity, and that said corporations are subject to the same restrictions and duties

as corporations formed in this State, and have no other or greater powers. . . . Foreign corporations cannot be permitted to come into this State for the purpose of asserting rights in contravention of our laws. . . . Citizens of Illinois cannot evade the laws of Illinois passed against trusts and combines by going into a foreign State and chartering a corporation to do business in this State in violation of its laws. When these foreign corporations come into this State they must conform to the laws and policy of this State. . . . If real estate in Illinois, owned by domestic corporations, cannot be used for the purpose of carrying out the business of an illegal trust or combination, real estate in Illinois, owned by a foreign corporation, cannot be used for such a purpose."

Compare, however, the extract from *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 428 (1903), (75 Pac. Rep. 89) in a preceding note to this section.

Compare also *Small v. Minneapolis, etc. Co.*, 57 Hun (N. Y.), 587 (1890), (10 N. Y. Supp. 456), where an injunction was refused in a stockholder's suit because both corporations — vendor and purchaser — were foreign corporations.

public, or violating fundamental conditions attached to the grant of the franchise.<sup>1</sup>

The formation of a combination of competing corporations by means of a holding or purchasing corporation, in violation of a rule of public policy, constitutes a misuser of the franchises of the latter corporation — the corporate combination — and subjects them to forfeiture in *quo warranto* proceedings.<sup>2</sup> The combination is injurious to public welfare because it is inimical to public policy. If involving *quasi*-public corporations it breaks the primary contract with the State.

<sup>1</sup> *State v. Minnesota Thresher Mfg. Co.*, 40 Minn. 213 (1889), (41 N. W. Rep. 1020, 3 L. R. A. 510).

In *People v. North River Sugar Refg. Co.*, 121 N. Y. 608 (1889), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33), Judge Finch said: "The judgment sought against the defendant is one of corporate death. The State which created asks us to destroy, and the penalty invoked represents the extreme rigor of the law. Its infliction must rest upon just cause and be warranted by material misconduct. The life of a corporation, is, indeed, less than that of the humblest citizen, and yet it envelops great accumulations of property, moves and carries in large volume the business and enterprise of the people, and may not be destroyed without clear and abundant reason. . . . It appears to be settled that the State, as prosecutor, must show on the part of the corporation accused some sin against the law of its being which has produced, or tends to produce, injury to the public. The transgression must not be merely formal or incidental but material and serious, and such as to harm the public welfare; for the State does not concern itself with the quarrels of private litigants."

<sup>2</sup> *Distilling, etc. Co. v. People*, 156 Ill. 448 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200); *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22

N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497). Also *People v. Chicago Live Stock Exch.*, 170 Ill. 556 (1897), (48 N. E. Rep. 1062, 62 Am. St. Rep. 404, 39 L. R. A. 373); *Coquard v. National Linseed Oil Co.*, 171 Ill. 480 (1898), (49 N. E. Rep. 563); *People v. Milk Exch.*, 145 N. Y. 267 (1898), (39 N. E. Rep. 1062, 45 Am. St. Rep. 609, 27 L. R. A. 437); *Stockton v. American Tobacco Co.*, 55 N. J. Eq. 52 (1897), (36 Atl. Rep. 971).

Where several corporations form a combination by means of a holding corporation for the elimination of competition, the State may proceed against the holding corporation whether it be a domestic or foreign corporation.

*Southern El. Securities Co. v. State*, (Miss. 1907), (44 So. Rep. 785).

A combination between several corporations entered into for the purpose of suppressing competition, fixing prices, and controlling production, cannot be declared void in a suit in equity brought by an outside dealer having no contractual relations with it but claiming to be injured, as such result can only be accomplished at the suit of the Government. An injunction, however, may be obtained against the continuance of wrongful acts of intimidation.

*Leonard v. Abner-Drury Brewing Co.*, 25 App. D. C. 161 (1905).

The fact that a corporation, under its charter, has power to purchase and hold property necessary for its business, does not authorize it to acquire competing plants in order to obtain control of the market for a commodity, contrary to the rule of public policy. In *Distilling, etc. Co. v. People*,<sup>1</sup> the Supreme Court of Illinois said: "The defendant is authorized to own such property as is necessary for carrying on its distillery business and no more. Its power to acquire and hold property is limited to that purpose, and it has no power by its charter to enter upon a scheme of getting into its hands, and under its control, all, or substantially all, the distilling plants and the distillery business of the country, for the purpose of controlling production and prices, of crushing out competition and of establishing a virtual monopoly in that business. Such purposes are foreign to the powers granted by the charter. Acquisitions of property to such extent and for such purpose, do not come within the authority to own the property necessary for the purpose of carrying on a general distillery business. In acquiring distillery properties, in the manner and for the purposes shown by the information, the defendant has not only misused and abused the powers granted by its charter, but has usurped and exercised powers not conferred by, but which are wholly foreign to, that instrument. It has thus rendered itself liable to prosecution by the State by *quo warranto*."

A stockholder is without authority to institute proceedings to forfeit the franchises of a corporation, upon the ground that it constitutes an unlawful combination. The remedy of *quo warranto* can only be enforced by the State.<sup>2</sup>

### § 373. Remedies of State — (B) Quo Warranto against Com-

<sup>1</sup> *Distilling, etc. Co. v. People*, 156 Ill. 448 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200).

<sup>2</sup> *Coquard v. National Linseed Oil Co.*, 171 Ill. 484 (1898), (49 N. E. Rep. 563): "The facts pleaded are insufficient to show the existence of a trust, but if they met the requirements in that regard, yet, so far as the public right is concerned which is the subject of so much argument, that fact would not authorize the filing of the bill by

the complainant for the forfeiture of the charter. Only the State can complain of injury to the public, or that public rights are being interfered with, and enforce a forfeiture of defendant's franchise for that reason."

See also *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 446 (1903), (75 Pac. Rep. 89); *Dittman v. Distilling Co.*, 64 N. J. Eq. 537 (1903), (54 Atl. Rep. 570).



**binning Corporations.** — Upon the principles considered in the last section, a corporation which becomes a member of an illegal association, or participates in the formation of an unlawful trust or corporate combination, is guilty of a misuser of its franchises, and they are subject to forfeiture in proceedings in *quo warranto* instituted by the State.<sup>1</sup>

A private corporation in entering such a combination exceeds its powers in a manner prejudicial to the public interest; a *quasi*-public corporation fails in the discharge of its public obligations and transgresses the law of its creation.<sup>2</sup>

<sup>1</sup> *California*. *Havemeyer v. Superior Court*, 84 Cal. 378 (1890), (24 Pac. Rep. 121, 18 Am. St. Rep. 192, 10 L. R. A. 641): "The doctrine is that corporate charters are granted upon the implied condition that the privileges conferred will be used for the advantage, or at least not to the disadvantage, of the State. If this condition is broken, the charter which the State has given is taken back by the State."

See also *People v. American Sugar Refg. Co.* (Super. Ct. San Francisco, 1890), 7 Ry. & Corp. L. J. 83.

*Indiana*. *State v. Portland Natural Gas, etc. Co.*, 153 Ind. 483 (1899), (53 N. E. Rep. 1089, 74 Am. St. Rep. 314, 53 L. R. A. 413).

*Mississippi*. Where several corporations form an unlawful combination for the purpose of stifling competition by means of a holding corporation to which controlling stock interests are transferred, the State may proceed against any of the domestic constituent companies.

*Southern Electric Sec. Co. v. State* (Miss. 1907), (44 So. Rep. 785).

*Nebraska*. *State v. Nebraska Distilling Co.*, 29 Neb. 719 (1890), (46 N. W. Rep. 155): "The findings in this case, to which no objections are made, clearly show that the object of the distilling company, in entering into the illegal combination, was to destroy competition and create a monopoly not only by limiting the production of alcohol, but, by dismantling as many

distilleries as the trust saw fit, absolutely prevent the manufacture of the article except in the few establishments controlled by the trust, and thus it would be enabled to control prices, prevent production and create a monopoly of the most offensive character. Any contract entered into with such an object in view is, under the laws of this State, null and void, and the conveyance from the distilling company to the trust was in contravention of the authority conferred by the statute on that company, in excess of the powers granted by its charter and against public policy and void, and no title passed by such conveyance. . . . As there has been an abuse of the corporate franchise, it will be dissolved and annulled."

In this case it was also held that a transfer of property pending *quo warranto* proceedings would not serve to evade the effect of the judgment.

*New York*. *People v. North River Sugar Refg. Co.*, 121 N. Y. 582 (1889), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33).

*Ohio*. *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145).

*Texas*. *San Antonio Gas Co. v. State*, 22 Tex. Civ. App. 118 (1899), (54 S. W. Rep. 118), (with especial reference to the Texas anti-trust statute).

<sup>2</sup> In *State v. Portland Natural Gas*,

Upon proof in *quo warranto* proceedings that a defendant corporation has entered into an illegal agreement for a combination, the courts may declare a forfeiture of its corporate franchise; or, it is held, may render a judgment of ouster from the right to make or carry out the combination agreement.<sup>1</sup>

§ 374. Remedies of State — (C) Injunction. — The State may file a bill for an injunction to restrain any *ultra vires* act of a corporation of a nature to produce public injury. It may enjoin the formation of an unlawful combination — association, trust or corporate combination. It is not obliged to wait until the organization has been completed, and all the injury possible is in process of infliction.<sup>2</sup>

etc. Co., 153 Ind. 491 (1899), (53 N. E. Rep. 1089, 74 Am. St. Rep. 314, 53 L. R. A. 413), the Supreme Court of Indiana said: "While appellee, by the agreement in controversy, cannot be said to have fully renounced autonomy, still it did so to the extent, at least, that it thereby disabled itself from supplying persons with gas who were patrons of the other company. By entering into this agreement, and carrying it into execution, appellee violated the principles of public policy, and clearly abused the rights and powers conferred upon it by the State, and may be said to have offended against the laws of its creation. Such an illegal act or agreement, upon the part of a corporation like appellee, cannot be permitted to override the law, and it was the manifest duty of the State to interpose as it has done, and call it to account; and if the charge made is established, a deserving penalty ought to be inflicted." See also, *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497).

<sup>1</sup> In *State v. Portland Natural Gas, etc. Co.*, 153 Ind. 491 (1899), (53 N. E. Rep. 1089, 74 Am. St. Rep. 314, 53 L. R. A. 413), the Court further said: "The rule is well settled that a court, in cases in *quo warranto* pro-

ceedings like this, if the facts justify, may, in the exercise of its discretion, render a judgment against the defendant declaring a forfeiture of its corporate franchises, or the judgment may be a forfeiture or ouster only of the right of the defendant to carry out or continue the illegal act or acts charged and established." See also, *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30 N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145).

In *quo warranto* proceedings against a corporation upon the ground that it is a party to an unlawful combination, the respondent corporation cannot object that the other members of the combination are not joined as defendants.

*Attorney-General v. A. Booth & Co.*, 143 Mich. 89 (1906), (106 N. W. Rep. 868).

<sup>2</sup> In *Trust Co. v. State*, 109 Ga. 747 (1900), (35 S. E. Rep. 323), the Supreme Court of Georgia said: "We have reached the conclusion that the sounder reasoning is in favor of allowing to the State relief by injunction whenever it is proceeding in the interest of the public to prevent a threatened injury. As harsh as the remedy by injunction is generally considered, it is certainly not as severe as would be a proceeding in the nature of *quo warranto*, instituted for the

If the State waits until the combination has been perfected, it may be partially deprived of its equitable remedy. An injunction will undoubtedly lie to restrain the continued operation of an association or trust, but it cannot be employed, as a substitute for *quo warranto* proceedings, to attack the corporate existence of a corporate combination. When a corporate combination has been formed, has acquired the plants of other companies and is transacting business, — all in the exercise of its apparent powers, — an injunction restraining it from the exercise of those powers, upon the ground that it was formed for an unlawful purpose, would be equivalent to an annulment of its charter. In such a case, *quo warranto* is the only remedy.<sup>1</sup>

purpose of forfeiting the charter of a corporation. The one is instituted, not for the purpose of causing a destruction of the corporation, but to prevent it from entering into transactions violative of the public policy of the State, and to protect the interest of the public against a threatened wrong. The other remedy, if enforced, would cause the death of the corporation, thus forever preventing it from serving the public interests, or meeting the public demands upon its business, and often result in a wreckage of the property of its owners. We can, therefore, see no reason why, if the remedy for the wrongs threatened can be as well prevented by injunction, it would not be the more readily and properly applied than the harsher one of forfeiture or confiscation."

See also, *Stockton v. Central R. Co.*, 50 N. J. Eq. 52 (1892), (24 Atl. Rep. 964, 17 L. R. A. 97); *People v. Aachen*, etc. Fire Ins. Co., 126 Ill. App. 636 (1906); *Queen Ins. Co. v. State* (Tex. Civ. App. 1893), 22 S. W. Rep. 1048; *Attorney-General v. Great Northern R. Co.*, 1 Drew & S. 154 (1860), (6 Jur. (N. S.), 1009). As to injunction against unincorporated combination, see *State v. American Cotton Oil Trust*, 40 La. Ann. 8 (1888), (3 So.

Rep. 409, 19 Am. & Eng. Corp. Cas. 448).

<sup>1</sup> *Stockton v. American Tobacco Co.*, 55 N. J. Eq. 368 (1897), (36 Atl. Rep. 971): "The first question which concerns us is whether these attacks upon the manner of creating the company do not directly challenge the existence of the corporation itself, for if this be so, it is entirely settled, in this State, that a court of equity has no jurisdiction to consider the matter at all. . . . (p. 370.) Now, in the case at bar it is charged that the purpose of the five concerns, the owners of which projected a scheme of incorporation, was to coalesce their separate competing business into one organization, for the purpose of destroying competition and controlling the trade in cigarettes. Whether the contracts preceding the act of incorporation . . . were inimical to public policy, I shall not stop to consider. If so, the agreement or agreements would have been unenforceable in any court, and it may be that upon a bill filed by the attorney-general such contract would have been annulled. But that contract has been executed. As a contract it has ceased to have any efficacy whatever. All that can be said of it in this case is that its provisions exhibit the

§ 375. **Evidence.** — The existence of an unlawful combination must be shown by evidence. Proof that a combination exists is not proof of its illegality.<sup>1</sup>

In establishing the illegal character of a combination, however, direct evidence of an unlawful object is not necessary.<sup>2</sup>

purposes for which the corporation was organized, and the sole question here is whether, if such purpose appears to have been to establish a monopoly through the instrumentality of this corporate organization, this court can, upon that ground, restrain any act done by the corporation itself within its corporate power. Now that such an exertion of power by a court of equity would strike at the authority of the corporation to act at all as a corporation is perfectly clear. The corporation must be either a legal or an illegal entity. If legal, then, as I have already observed, it possesses the right to dispose of its goods in its adopted manner. If illegal, it has no right to transact any business at all as a corporation. An injunction which would, in the language of the prayer of the bill, restrain the company from using the corporate organization in the conduct of their business of making and selling paper cigarettes, and from carrying on any portion of their business in the name of the American Tobacco Company, would be as efficient an annulment of their franchise as would be a judgment against them upon *quo warranto*."

<sup>1</sup> *Herriman v. Menzies*, 115 Cal. 16 (1896), (44 Pac. Rep. 660, 56 Am. St. Rep. 82, 35 L. R. A. 319): "We are not at liberty to indulge in inferences which would restrict the parties in their right to combine their interests. Parties are to be given the widest latitude to make contracts with reference to their private interests, and the invalidity of such contracts is never to be inferred, but must be clearly made to appear."

See also *Leslie v. Lorillard*, 110

N. Y. 533 (1888), (18 N. E. Rep. 363, 1 L. R. A. 456); *Central Shade Roller Co. v. Cushman*, 143 Mass. 353 (1887), (9 N. E. Rep. 629).

Where in an action upon a lease the defence is set up that it is invalid as being part of a scheme to create an unlawful combination, the question whether it was made for such purpose is for the jury.

*Hartz v. Eddy*, 140 Mich. 479 (1905), (103 N. W. Rep. 852).

But if all the evidence concerning a contract — the circumstances attending its execution, the result to be accomplished and the practical construction of the parties — is consistent only with an unlawful purpose, the question of illegality should not be submitted to the jury. And this is true notwithstanding the contract is not illegal upon its face.

*Detroit Salt Co. v. National Salt Co.*, 134 Mich. 103 (1903), (96 N. W. Rep. 1).

<sup>2</sup> *Harding v. American Glucose Co.*, 182 Ill. 635 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738): "It makes no difference that the agreement for the illegal combination is not a formal written agreement. It may be a verbal agreement or understanding, or a scheme not embodied in writing, but evidenced, by the action of the parties." See also *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1906), (56 S. E. Rep. 269, 116 Am. St. Rep. 901, 10 L. R. A. (N. S.) 268).

In *quo warranto* proceedings to oust certain corporations from the State as constituting an unlawful combination, statements of the authorized representatives of such cor-

The purpose of a combination to control the market is seldom evidenced by a single instrument, or expressly stated in any instrument. It is shown by a series of acts and transactions. Similarly, an illegal combination of *quasi*-public corporations may be of the most innocent character in its stated purpose.

It is the duty of the court to view the agreement of the parties in the light of all the surrounding circumstances, and to receive any evidence tending to show the true situation and real purposes of the parties to the combination. This course has been followed by the courts in the leading cases of *quo warranto* which have already been adverted to.<sup>1</sup>

porations with respect to the methods of transacting business are admissible in evidence against such corporations.

*State v. Armour Packing Co.*, 173 Mo. 356 (1903), (73 S. W. Rep. 645, 96 Am. St. Rep. 515).

<sup>1</sup> *People v. North River Sugar Refg. Co.*, 121 N. Y. 582 (1889), (24 N. E. Rep. 834, 18 Am. St. Rep. 843, 9 L. R. A. 33); *State v. Standard Oil Co.*, 49 Ohio St. 137 (1892), (30

N. E. Rep. 279, 34 Am. St. Rep. 541, 15 L. R. A. 145); *Distilling, etc. Co. v. People*, 156 Ill. 448 (1895), (41 N. E. Rep. 188, 47 Am. St. Rep. 200); *People v. Chicago Gas Trust Co.*, 130 Ill. 268 (1889), (22 N. E. Rep. 798, 17 Am. St. Rep. 319, 8 L. R. A. 497); *State v. Nebraska Distilling Co.*, 29 Neb. 700 (1890), (46 N. W. Rep. 155).

## ARTICLE III

## LEGISLATION AFFECTING COMBINATIONS

## I

## FEDERAL ANTI-TRUST STATUTE

## CHAPTER XXXVIII

## THE STATUTE AND ITS CONSTITUTIONALITY

- § 376. The Statute.
- § 377. Analysis of Statute.
- § 378. Object of Statute.
- § 379. Constitutionality of Act — (A) Power of Congress under Commerce Clause to legislate concerning Private Contracts affecting Interstate Commerce.
- § 380. Constitutionality of Act — (B) Power of Congress under Commerce Clause to legislate concerning Contracts and Combinations under State Laws.
- § 381. Constitutionality of Act — (C) Power of Congress under Commerce Clause to prohibit Combinations of Competing Railroads.
- § 382. Constitutionality of Act — (D) Act is Constitutional.
- § 383. Legislation supplementing the Statute — (1) Anti-trust Provisions of Wilson Tariff Act.
- § 384. Legislation supplementing the Statute — (2) The Expedition Act.
- § 385. Legislation supplementing the Statute — (3) The Immunity Proviso.

§ 376. **The Statute.** — The federal anti-trust act, generally called the “Sherman Act,” and entitled “An Act to protect trade and commerce against unlawful restraints and monopolies,” was approved July 2, 1890. It is printed in full in the footnote.<sup>1</sup>

<sup>1</sup> “§ 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations,

is hereby declared to be illegal. Every person who shall make any such contract, or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and,

§ 377. **Analysis of Statute.** — The sections of the act may be classified, primarily, into

(I) Sections declaring what “restraints and monopolies” the act is directed against, and prescribing penalties — sections 1, 2, and 3.

on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

“ § 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

“ § 3. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is hereby declared illegal. Every person who shall make any such contract or engage in any combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

“ § 4. The several circuit courts of

the United States are hereby invested with jurisdiction to prevent and restrain violations of this act; and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition, the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

“ § 5. Whenever it shall appear to the court before which any proceeding under section four of this act may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpoenas to that end may be served in any district by the marshal thereof.

“ § 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this act, and being in the course of transportation from one State to another, or to a foreign country, shall be forfeited to the United States, and may be seized

(II) Sections relating to remedies and procedure — sections 4, 5, 6 and 7.<sup>1</sup>

(III) Section declaring rule of construction — section 8.

The last section — forming Class III and providing that the word “person” or “persons” shall include corporations and associations — requires no analysis. Class II — the sections relating to remedies and procedure — will be the subject of consideration in another chapter. The several sections in Class I may be subdivided into

(1) Definitions of offences.

(2) Statements of penalties.

The penalties prescribed in the act will be considered in connection with remedies and procedure. The offences described in the several sections of Class I are as follows:

*Under section 1:* Every (a) contract, (b) combination in the form of trust or otherwise, or (c) conspiracy, *in restraint of trade or commerce among the several States or with foreign nations*, is illegal.

*Under section 2:* Every person who shall (a) monopolize, or (b) attempt to monopolize, or (c) combine or (d) conspire with any other person or persons, to monopolize, any part of *the trade or commerce among the several States or with foreign nations*, shall be deemed guilty of a misdemeanor.

*Under section 3:* The acts and agreements described in section 1, if in restraint of trade or commerce in any Territory (including the District of Columbia), or *between Territories and other Territories, States and foreign nations*, are illegal.

and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

“§ 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover

threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

“§ 8. That the word ‘person’ or ‘persons,’ wherever used in this act, shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.”

<sup>1</sup> Section 6 also provides an additional penalty of forfeiture, and section 7, of treble damages.



From this analysis the following conclusions follow:

1. The "restraints and monopolies" referred to in the title to the act are

(A) Contracts, combinations and conspiracies in restraint of interstate (including territorial and interterritorial) and foreign trade or commerce.

(B) Monopolizing, or attempting, combining or conspiring to monopolize, interstate or foreign trade or commerce.

2. Such "restraints and monopolies" are illegal.

§ 378. **Object of Statute.** — The statute is aimed at all restrictions upon interstate commerce. Its purpose is to permit trade and commerce, between the States and with foreign nations, to flow in their natural channels, "unrestricted by any combinations, contracts, conspiracies, or monopolies whatsoever."<sup>1</sup> In *United States v. Coal Dealers Association*,<sup>2</sup> Judge Morrow said: "The clear and positive purpose of the statute must be understood to be that trade and commerce, within the jurisdiction of the federal government, shall be absolutely free, and no contract or combination will be tolerated that impedes or restricts their natural flow and volume."

The purpose of a statute must be gathered, primarily, from its language; and, as will be shown, this act has been construed to apply to combinations of competing carriers, as well as to industrial combinations. An examination of the "history of the times," moreover, — using a phrase of the Supreme Court of the United States, — will show that while the principal object of Congress, in enacting the statute, may have been the suppression of combinations of industrial corporations in restraint of interstate commerce, the prevention of combinations between competing railroad companies was not outside its purpose.<sup>3</sup>

<sup>1</sup> *United States v. Hopkins*, 82 Fed. 537 (1897).

<sup>2</sup> *United States v. Coal Dealers Ass'n*, 85 Fed. 261 (1898).

<sup>3</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 319 (1897), (17 Sup. Ct. Rep. 540): "It is said that Congress had very different matters in view, and very different objects to accomplish in the passage

of the act in question; that a number of combinations in the form of trusts and conspiracies in restraint of trade were to be found throughout the country, and that it was impossible for the State governments to successfully cope with them, because of their commercial character, and of their business extension through the different States of the Union. Among

**§ 379. Constitutionality of Act — (A) Power of Congress under Commerce Clause to legislate concerning Private Contracts affecting Interstate Commerce.** — The Constitution of the United States provides that Congress shall have power "to regulate commerce with foreign nations, and among the several States and with the Indian Tribes."<sup>1</sup> Under this grant of

these trusts it was said in Congress, were the Beef Trust, the Standard Oil Trust, the Steel Trust, the Barbed Wire Fence Trust, the Sugar Trust, the Cordage Trust, the Cotton Seed Oil Trust, the Whiskey Trust, and many others, and these trusts, it was stated, had assumed an importance and had acquired a power which were dangerous to the whole country, and that their existence was directly antagonistic to its peace and prosperity. To combinations and conspiracies of this kind, it is contended that the act in question was directed, and not to the combinations of competing railroads to keep up their prices to a reasonable sum for the transportation of persons and property. It is true that many and various trusts were in existence at the time of the passage of the act, and it was probably sought to cover them by the provisions of the act. Many of them had rendered themselves offensive by the manner in which they exercised the great power that combined capital gave them. But a further investigation of 'the history of the times' shows also that those trusts were not the only associations controlling a great combination of capital which had caused complaint at the manner in which their business was conducted. There were many and loud complaints from some portions of the public regarding the railroads and the prices they were charging for the service they rendered, and it was alleged that the prices for the transportation of persons and articles of commerce were unduly and improperly enhanced by combinations among the different

roads. Whether these complaints were well or ill founded we do not presume at this time and under these circumstances to determine or discuss. It is simply for the purpose of answering the statement that it was only to trusts of the nature above set forth that this legislation was directed, that the subject of the opinions of the people in regard to the actions of the railroad companies in this particular is referred to. A reference to this history of the times does not, as we think, furnish us with any strong reason for believing that it was only trusts that were in the minds of the members of Congress, and that railroads and their manner of doing business were wholly excluded therefrom."

<sup>1</sup> Constitution of the United States, Art. I, § 8: "The Congress shall have Power . . . to regulate commerce with foreign nations, and among the several States and with the Indian Tribes."

By the adoption of this clause in its grant of legislative powers the Constitutional Convention created the federal commercial power and prescribed for commercial regulation. And yet no member of the Convention appreciated the possibilities of the language used. There is nothing to indicate that anything further was intended than the uniform regulation of foreign commerce and the prevention of imposts at State lines. The widening scope of the commerce clause — the development of the essentially nationalizing power — has been brought about through its interpretation, in the light of history

power, Congress may enact laws declaring illegal and prohibiting the performance of contracts between individuals or corporations, the natural and direct — as distinguished from the incidental and collateral — effect of the operation of which will be to regulate, to any extent, interstate or foreign commerce.<sup>1</sup> The provision in the Constitution regarding the liberty of the citizen,<sup>2</sup> although including liberty of contract, does not limit the power of Congress, under the commerce clause, to legislate upon the subject of contracts affecting, in any degree, commerce among the States.

In *Addyston Pipe, etc. Co. v. United States*,<sup>3</sup> Mr. Justice Peckham said: "It is insisted by the appellants, at the threshold of the inquiry, that, by the true construction of the Constitution, the power of Congress to regulate interstate commerce is limited to its protection from acts of interference by State legislation or by means of regulations made under the authority of the State by some political subdivision thereof, . . . but that it does not include the general power to interfere with or prohibit private contracts between citizens, even though such contracts have interstate commerce for their object, and result in a direct and substantial obstruction to or regulation of that commerce, . . . The power to regulate interstate commerce is, as stated by Chief Justice Marshall, full and complete in Congress, and there is no limitation in the grant of the power which excludes private contracts of the nature in question from the jurisdiction of that body. Nor is any such limitation contained in the other clause of the Constitution, which provides that no person shall be deprived of life, liberty or property without due process of law. . . . The provision in the Con-

and the nation's growth, by the Supreme Court of the United States. The series of decisions marking that development mark also American commercial progress.

<sup>1</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 226 (1899), (20 Sup. Ct. Rep. 96); *United States v. Joint Traffic Ass'n*, 171 U. S. 571 (1898), (19 Sup. Ct. Rep. 25).

<sup>2</sup> The Fifth Amendment of the Constitution provides that "no person

shall be . . . deprived of life, liberty or property without due process of law; nor shall private property be taken without just compensation."

<sup>3</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 226 (1899), (20 Sup. Ct. Rep. 96).

See also opinion of Mr. Justice Harlan in *Northern Securities Co. v. United States*, 193 U. S. 197, 342 (1904), (24 Sup. Ct. Rep. 436).

stitution does not, as we believe, exclude Congress from legislating with regards to contracts of the above nature, while in the exercise of its constitutional right to regulate commerce among the States. On the contrary, we think the provision regarding the liberty of the citizen is, to some extent, limited by the commerce clause of the Constitution, and that the power of Congress to regulate interstate commerce comprises the right to enact a law prohibiting the citizen from entering into those private contracts which directly and substantially, and not merely indirectly, remotely, incidentally and collaterally, regulate, to a greater or less degree, commerce among the States.”<sup>1</sup>

**§ 380. Constitutionality of Act — (B) Power of Congress under Commerce Clause to legislate concerning Contracts and Combinations under State Laws.** — The power of Congress, under the commerce clause of the Constitution, to legislate concerning contracts and combinations affecting commerce among the States is not affected by the fact that they may have been entered into under State laws. The States have no power to place restraints upon interstate commerce nor to authorize corporations or individuals to do so. State legislation can never serve as a shield against the assertion of federal authority over such commerce.

It is no violation of the reserved rights of the States for Congress to enact that no persons, natural or artificial, shall enter

<sup>1</sup> Compare this decision with that in *In re Greene*, 52 Fed. 112 (1892), where the constitutional limitations upon the power of Congress are also considered. Judge Jackson said: “Congress may place restrictions and limitations upon the right of corporations created and organized under its authority to acquire, use, and dispose of property. It may also impose such restrictions and limitations upon the citizen in respect to the exercise of a public privilege or franchise by the United States. But Congress, certainly, has not the power or authority under the commerce clause, or any other provision of the Constitution, to limit and restrict the right of corporations created by the States, or

the citizens of the States, in the acquisition, control, and disposition of property. Neither can Congress regulate or prescribe the price or prices at which such property, or the products thereof, shall be sold by the owner or owners, whether corporations or individuals. It is equally clear that Congress has no jurisdiction over, and cannot make criminal, the aims, purposes, and intentions of persons in the acquisition and control of property, which the States in their residence or creation sanction and permit. It is not material that such property, or the products thereof, may become the subject of trade and commerce among the several States or with foreign nations.”

into a contract or combination in restraint of interstate commerce. The States have no power to charter corporations to break such a law. No corporation can rely upon its chartered powers to justify breaking such a law. The federal anti-trust statute is not unconstitutional as trenching upon the powers of the States.

Mr. Justice Harlan considers at length these questions in his opinion in the *Northern Securities Case*, extracts from which are printed in the footnote.<sup>1</sup>

<sup>1</sup> The *Northern Securities Case* (193 U. S. 197 (1904), (24 Sup. Ct. Rep. 436) is examined at length in *post*, § 397a. The following extracts from Mr. Justice Harlan's opinion relate to the question of constitutionality: "Now, the court is asked to adjudge that, if held to embrace the case before us, the Anti-trust Act is repugnant to the Constitution of the United States. In this view we are unable to concur. The contention of the defendants could not be sustained without, in effect, overruling the prior decisions of the court as to the scope and validity of the Anti-trust Act. . . . If private parties may not, by combination among themselves, restrain interstate and international commerce in violation of an act of Congress, much less can such restraint be tolerated when imposed or attempted to be imposed upon commerce as carried on over public highways. Indeed, if the contentions of the defendants are sound, why may not *all* the railway companies in the United States, that are engaged, under State charters, in interstate and international commerce, enter into a combination such as the one here in question, and by the device of a holding corporation obtain the absolute control throughout the entire country of rates for passengers and freight, beyond the power of Congress to protect the public against their exactions? . . . All, we take it, will agree, as estab-

lished firmly by the decisions of this court, that the powers of Congress over commerce extend to all the instrumentalities of such commerce, and to every device that may be employed to interfere with the freedom of commerce among the States and with foreign nations. Equally, we assume, all will agree that the Constitution and the legal enactments of Congress are, by express words of the Constitution, the supreme law of the land, anything in the constitution and laws of any State to the contrary notwithstanding. Nevertheless, the defendants, strangely enough, invoke in their behalf the Tenth Amendment of the Constitution which declares that 'the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively or to the People,' and we are confronted with the suggestion that any order or decree of the federal court which will prevent the *Northern Securities Company* from exercising the power it acquired in becoming the holder of the stocks of the *Great Northern* and *Northern Pacific Railway* companies will be an invasion of the rights of the State under which the *Securities Company* was chartered, as well as the rights of the States creating the other companies. In other words, if the State of New Jersey gives a charter to a corporation, and even if the obtaining of

§ 381. **Constitutionality of Act — (C) Power of Congress under Commerce Clause to prohibit Combinations of Competing Railroads.** — In the exercise of the power conferred in the commerce clause of the Constitution, Congress may enact legislation, applicable to railroad companies, declaring illegal all contracts and combinations which, in its opinion, restrain or impede interstate or foreign commerce by restricting or extinguishing competition.<sup>1</sup> It is for Congress to determine what contracts and combinations are prejudicial to the public welfare, and the courts may not declare an act of Congress unconstitutional on account of such determination, except, possibly, in a case of gross abuse of power.

In *United States v. Joint Traffic Association*,<sup>2</sup> the Supreme Court of the United States said: "Has not Congress, with regard to interstate commerce and in the course of regulating it, in the case of railroad corporations, the power to say that no contract or combination shall be legal which shall restrain trade and commerce by shutting out the operation of the general laws of competition? We think it has. . . . The business of a railroad carrier is of a public nature, and, in perform-

such charter is in fact pursuant to a *combination* under which it becomes the holder of the stocks of shareholders in two competing parallel railroad companies engaged in interstate commerce in other States, whereby competition between the respective roads of those companies is to be destroyed and the enormous commerce carried on over them restrained by suppressing competition, Congress must stay its hand and allow such restraint to continue to the detriment of the public because, forsooth, the corporations concerned, or some of them, are State corporations. . . . We reject any such view of the relations of the National Government and the States composing the Union, as that for which the defendants contend. Such a view cannot be maintained without destroying the just authority of the United States. It is inconsistent with all the decisions of

this court as to the powers of the National Government over matters committed to it. No State can, by merely creating a corporation, or in any other mode, project its authority into other States, and across the continent, so as to prevent Congress from exerting the power it possesses under the Constitution over interstate and international commerce, or so as to exempt its corporation engaged in interstate commerce from obedience to any rule lawfully established by Congress for such commerce."

<sup>1</sup> *United States v. Joint Traffic Ass'n*, 171 U. S. 505 (1898), (19 Sup. Ct. Rep. 25); *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540).

<sup>2</sup> *United States v. Joint Traffic Ass'n*, 171 U. S. 566 (1898), (19 Sup. Ct. Rep. 25).

ing it, the carrier is also performing, to a certain extent, a function of government which, as counsel observed, requires them to perform the service upon equal terms to all. This public service, that of transportation of passengers and freight, is a part of trade and commerce, and when transported between States such commerce becomes what is described as interstate, and comes, to a certain extent, under the jurisdiction of Congress, by virtue of its power to regulate commerce among the several States. Where the grantees of this public franchise are competing railroad companies for interstate commerce, we think Congress is competent to forbid any agreement or combination among them by means of which competition is to be smothered. Although the franchise, when granted by the State, becomes by the grant the property of the grantee, yet there are some regulations respecting the exercise of such grants which Congress may make under its power to regulate commerce among the several States. This will be conceded by all, the only question being as to the extent of the power. We think it extends, at least, to the prohibition of contracts relating to interstate commerce, which would extinguish all competition between otherwise competing railroad corporations, and which would, in that way, restrain interstate trade or commerce. . . . The prohibition of such contracts may, in the judgment of Congress, be one of the reasonable necessities for the proper regulation of commerce, and Congress is the judge of such necessity and propriety, unless, in case of a possible gross perversion of the principle, the courts might be applied to for relief."

§ 382. **Constitutionality of Act — (D) Act is Constitutional.** — It follows, as a corollary to the conclusions reached in the preceding sections, that the federal anti-trust statute, having been enacted by Congress in the exercise of the power conferred upon it by the commerce clause of the Constitution, and having for its object the elimination of all contracts, combinations and conspiracies for restraining or monopolizing interstate or foreign commerce, is constitutional; and it has been so held by the Supreme Court of the United States.<sup>1</sup>

<sup>1</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 211 (1899), (20 Sup. Ct. Rep. 96); *United States v. Joint*

*Traffic Ass'n*, 171 U. S. 505 (1898), (19 Sup. Ct. Rep. 25).

See also *United States v. Trans-*

§ 383. **Legislation supplementing the Statute — (1) Anti-trust Provisions of Wilson Tariff Act.** — The anti-trust provisions of the Wilson Tariff Act of August 27, 1894 — relating to combinations to which an importer is a party — are printed in the subjoined note.<sup>1</sup>

These provisions, in respect of their subject-matter, follow the lines of the federal anti-trust statute and are even broader in their terms. They declare illegal every combination, trust, agreement or contract entered into by two or more persons or corporations, either of whom is an importer, when intended to operate in restraint of trade or free competition, or to increase the market price in the United States of any imported article or manufacture into which such article enters.<sup>2</sup>

The jurisdictional provisions and those relating to procedure and penalties are substantially identical with those of the federal anti-trust statute.

§ 384. **Legislation supplementing the Statute — (2) The Expedition Act.** — The federal anti-trust statute provides that the circuit courts shall proceed “as soon as may be” to the

Missouri Freight Ass’n, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540); *United States v. Jellico Mountain Coal, etc. Co.*, 46 Fed. 432 (1891).

<sup>1</sup> “§ 73. That every combination, conspiracy, trust, agreement, or contract is hereby declared to be contrary to public policy, illegal, and void, when the same is made by or between two or more persons or corporations either of whom is engaged in importing an article from any foreign country into the United States, and when such combination, conspiracy, trust, agreement, or contract is intended to operate in restraint of lawful trade, or free competition in lawful trade or commerce, or to increase the market price in any part of the United States of any article or articles imported or intended to be imported into the United States, or of any manufacture into which such imported article enters or is intended to enter. Every person

who is or shall hereafter be engaged in the importation of goods or any commodity from any foreign country in violation of this section of this act, or who shall combine or conspire with another to violate the same, is guilty of a misdemeanor, and, on conviction thereof in any court of the United States, such person shall be fined in a sum not less than one hundred dollars and not exceeding five thousand dollars, and shall be further punished by imprisonment, in the discretion of the court, for a term not less than three months nor exceeding twelve months.”

§§ 74, 75, 76 and 77 of the Wilson Act are practically the same as §§ 4, 5, 6 and 7 respectively of the Sherman Act.

<sup>2</sup> These provisions were continued in force by the Dingley Tariff Act of 1897. They have never been construed by the Supreme Court of the United States.



hearing and determination of causes brought under it. Such causes for some thirteen years after the enactment of the statute were appealable to the circuit courts of appeals and thence as other causes to the Supreme Court.

In 1903, however, a statute was passed making further provision for expediting the hearing of causes brought under the anti-trust statute, as well as under the Interstate Commerce Act, and giving the sole right of appeal directly from the circuit court to the Supreme Court. This expedition statute is printed in the footnote.<sup>1</sup>

§ 385. **Legislation supplementing the Statute — (3) The Immunity Proviso.** — The appropriation act of February 25, 1903,<sup>2</sup> made an appropriation for the enforcement of the provisions of the federal anti-trust statute and contained the following provisions: "*Provided*, That no person shall be

"§ 1. In any suit in equity pending or hereafter brought in any circuit court of the United States under the Act entitled 'An Act to protect trade and commerce against unlawful restraints and monopolies,' approved July second, eighteen hundred and ninety, 'An Act to regulate commerce,' approved February fourth, eighteen hundred and eighty-seven, or any of the Acts having a like purpose that hereafter may be enacted, wherein the United States is complainant, the Attorney-General may file with the clerk of such court a certificate that, in his opinion the case is of general public importance, a copy of which shall be immediately furnished by such clerk to each of the circuit judges of the circuit in which the case is pending. Thereupon such case shall be given precedence over others and in every way expedited, and be assigned for hearing at the earliest practicable day, before not less than three of the circuit judges of said circuit, if there be three or more; and if there be not more than two circuit judges, then before them and such district judge as they may select. In the

event that the judges sitting in such case shall be divided in opinion, the case shall be certified to the Supreme Court for review in like manner as if taken there by appeal as hereinafter provided.

"§ 2. That in every suit in equity pending or hereafter brought in any circuit court of the United States under any of said Acts, wherein the United States is complainant, including cases submitted but not yet decided, an appeal from the final decree of the circuit court will lie only to the Supreme Court and must be taken within sixty days from the entry thereof: *Provided*, That in any case where an appeal may have been taken from the final decree of a circuit court to the circuit court of appeals before this Act takes effect, the case shall proceed to a final decree therein, and an appeal may be taken from such decree to the Supreme Court in the manner now provided by law."

<sup>2</sup> 32 Stat. at Large, Part 1, p. 903. For construction of this proviso see *post*, § 413, "*Interpretation of Immunity Proviso.*"

prosecuted or be subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, in any proceeding, suit, or prosecution under said acts: *Provided further*, that no person so testifying shall be exempt from prosecution or punishment for perjury committed in so testifying."

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## CHAPTER XXXIX

### CONSTRUCTION AND APPLICATION OF FEDERAL STATUTE

- § 386. Title of Statute.
- § 387. Use of Phrase "Contract in Restraint of Trade." Application of Statute to Ancillary Contracts.
- § 388. Statute not limited to Unreasonable Restraint of Trade.
- § 389. Use of Terms "Monopolize" and "Monopolies."
- § 390. Meaning of Phrase "Trade or Commerce among the Several States."
- § 391. Statute applies only to Restraints upon Interstate or International Commerce.
- § 392. Restraint upon Interstate Commerce must be Direct — (A) In General.
- § 393. Restraint upon Interstate Commerce must be Direct — (B) Combinations relating to Manufacture and of Manufacturers and Producers.
- § 394. Restraint upon Interstate Commerce must be Direct — (C) Restraints upon Facilities for Commerce.
- § 395. Restraint upon Interstate Commerce must be Direct — (D) Exchanges and Similar Associations.
- § 396. Restraint may be imposed upon those engaged in Interstate Commerce by those not engaged therein.
- § 397. Form of Combination Immaterial. Illegality of Corporate Device.
- § 397a. The Northern Securities Case.
- § 398. Application of Statute to Combinations of Railroads and Other Carriers. Combinations of Railroad Employees.
- § 399. Application of Statute to Combinations under Patents.
- § 400. Application of Statute to Combinations under Copyrights.
- § 401. Application of Statute to Combinations under Secret Processes.
- § 402. Application of Statute to Contracts concerning Market Quotations.
- § 403. Application of Statute to State's Monopoly and State Regulations.
- § 404. Statute not Retroactive but applies to Continuing Combinations.

§ 386. **Title of Statute.** — The title of the federal anti-trust statute is "An Act to protect trade and commerce from unlawful restraints and monopolies."

The body of the act declares illegal "every contract . . . in restraint of trade or commerce," etc., but does not use the word "unlawful."

It seems manifest that the word "unlawful" in the title applies to the acts declared illegal in the body of the act, without regard to their previous illegality at common law or under State statutes. In the *Trans-Missouri Freight Association Case*, however, it was contended that the title indicated an intention to include only those contracts which were unlawful at common law, but which would require a federal statute to be dealt with in a federal court. In answer to this contention, Mr. Justice Peckham said:<sup>1</sup> "It is said that when terms which are known to the common law are used in a federal statute, those terms are to be given the same meaning that they received at common law, and that when the language of the title is to 'protect trade and commerce against unlawful restraints and monopolies,' it means those restraints and monopolies which the common law regarded as unlawful, and which were to be prohibited by the federal statute. We are of opinion that the language used in the title refers to and includes, and was intended to include, those restraints and monopolies which are made unlawful in the body of the statute. It is to the statute itself that resort must be had to learn the meaning thereof, though a resort to the title here creates no doubt about the meaning of, and does not alter, the plain language contained in its text."<sup>2</sup>

§ 387. Use of Phrase "Contract in Restraint of Trade." **Application of Statute to Ancillary Contracts.** — If competition develops trade, that which limits competition restrains trade. So the phrase "contract in restraint of trade," without any judicial history, would naturally be given a broad meaning corresponding to the signification of the words composing it. But, as we have seen, the phrase many years ago acquired a well-defined meaning as describing contracts, ancillary to a principal

<sup>1</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 327 (1897), (17 Sup. Ct. Rep. 540).

See also *United States v. Coal Dealers Ass'n*, 85 Fed. 261 (1898).

<sup>2</sup> Compare, however, the language of Mr. Justice Brewer in his concurring opinion in the *Northern Securities Case*, 193 U. S. 197, 361 (1904), (24 Sup. Ct. Rep. 436).

contract, — generally of sale, — whereby a person agrees to refrain from engaging in some trade, business or occupation. And still, as we have also seen, notwithstanding this early usage and the development of legal rules governing such ancillary contracts, the meaning of the phrase in more recent years has broadened, and it was used in a comprehensive sense at the time of the enactment of the federal anti-trust statute.<sup>1</sup>

It is clear that the phrase "contract in restraint of trade" is used in its broad sense in the federal statute. It includes "*all kinds of those contracts which in fact restrain or may restrain trade.*"<sup>2</sup> "The natural effect of competition is to increase commerce, and an agreement whose direct effect is to prevent this play of competition restrains instead of promotes trade and commerce."<sup>3</sup> Broadly speaking, therefore, the phrase embraces all agreements which restrain or tend to restrain competition in any degree. Total suppression of trade in a commodity as a result of an agreement is not necessary to make it a contract in restraint of trade.<sup>4</sup>

This broad use of the phrase "contract in restraint of trade" is, manifestly, necessary to give any practical effect to the statute. Its purpose is to protect interstate trade and commerce and its application could hardly be confined to a class of contracts which, except in the instance of a collateral agreement to refrain from engaging in the transportation business,

<sup>1</sup> See *ante*, § 336, "*Modern Use of Phrase 'Contract in Restraint of Trade.'*"

The objection to such broad use of the phrase is that pointed out in the section referred to — testing the validity of contracts of an essentially different nature from those ancillary agreements to which the phrase originally applied by the legal principles governing those agreements.

<sup>2</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 329 (1897), (17 Sup. Ct. Rep. 540).

<sup>3</sup> *Northern Securities Co. v. United States*, 193 U. S. 197 (1904), (24 Sup. Ct. Rep. 436).

<sup>4</sup> In *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 244 (1899),

(20 Sup. Ct. Rep. 96), the Supreme Court said: "We have no doubt but that where the direct and immediate effect of a contract or combination among particular dealers in a commodity is to destroy competition between them and others so that the parties to the contract or combination may obtain increased prices for themselves, such contract or combination amounts to a restraint of trade in the commodity, even though contracts to buy such commodity at the enhanced price are continually being made. Total suppression of the trade in a commodity is not necessary in order to render the combination one in restraint of trade."

could hardly have any effect upon interstate commerce at all. In fact, the curious anomaly is presented of a statute directed broadly against contracts in restraint of trade which is inapplicable to the very class of contracts which were *primarily* in restraint of trade.

In the *Trans-Missouri Freight Association Case*<sup>1</sup> Mr. Justice Peckham said: "A contract which is the mere accompaniment of the sale of property, and thus entered into for the purpose of enhancing the price at which the vendor sells it, which, in effect, is collateral to such sale, and where the main purpose of the whole contract is accomplished by such sale, might not be included within the title or the spirit of the statute in question." And in the recent opinion of Mr. Justice Holmes in *Cincinnati Packet Company v. Bay*<sup>2</sup> it seems to be definitely

<sup>1</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 329 (1897), (17 Sup. Ct. Rep. 540).

See also concurring opinion of Mr. Justice Brewer in the *Northern Securities Case*, 193 U. S. 197, 361 (1904), (24 Sup. Ct. Rep. 436).

<sup>2</sup> *Cincinnati Packet Co. v. Bay*, 200 U. S. 179 (1906), (26 Sup. Ct. Rep. 208).

In this case the vendors in a contract for the sale of vessels agreed, as a part of the consideration, to withdraw from the business of operating vessels between certain points for a specified period. In a suit upon the contract it was set up that this covenant in the contract was in restraint of trade in violation of the federal anti-trust statute. But Mr. Justice Holmes said (p. 184): "It is argued, to be sure, that the last mentioned covenant is independent and not connected with the sale of the vessels. The contrary is manifest as a matter of good sense, and is proved even technically by the words 'it is also agreed as a part of the consideration of this agreement.' By these words the covenant not to do business between Cincinnati and Portsmouth for five years is imported into the

sale of the ships, and made one of the conventional inducements of the purchase. The price is paid, not for the vessels alone, but for the vessels with the covenant. So, still more clearly, the parallel instalments for five years are paid for the covenant, at least in part. It is said that there is no sale of good-will. But the covenant makes the sale. Presumably all that there was to sell, beside certain instruments of competition, was the competition itself, and the purchasers did not want the vendors' names. This being our view of the covenant in question, whatever differences of opinion there may have been with regard to the scope of the act of July 2, 1890, there has been no intimation from any one, we believe, that such a contract, made as part of the sale of a business and not as a device to control commerce, would fall within the act. On the contrary, it has been suggested repeatedly that such a contract is not within the letter or spirit of the statute (*United States v. Trans-Missouri Freight Association*, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540); *United States v. Joint Traffic Association*, 171 U. S. 505 (1898), (19 Sup.

decided that such ancillary contracts "made as a part of the sale of a business and not as a device to control commerce" are not within the statute.<sup>1</sup> But if an agreement, although in the form of an ancillary contract, goes further than is necessary for the purposes of such a contract and "presents acts in aid of a scheme of monopoly," it is unlawful.<sup>2</sup>

Ct. Rep. 25)); and it was so decided in the case of a patent (*Bement v. National Harrow Co.*, 186 U. S. 70 (1902), (22 Sup. Ct. Rep. 747). It would accomplish no public purpose, but simply would provide a loophole of escape to persons inclined to elude performance of their undertakings if the sale of a business and temporary withdrawal of the seller necessary in order to give the sale effect, were to be declared illegal in every case where a nice scrutiny could discover that the covenant possibly might reach beyond the State line. We are of opinion that the agreement before us is not made illegal by either of the provisions thus far discussed."

<sup>1</sup> In *Brett v. Ebel*, 29 App. Div. (N. Y.) 256 (1898), (51 N. Y. Supp. 573) a party sold "all his interest and good-will in the business of freighting vessels" for a certain port and covenanted for a specified period to refrain from doing any business with such port. It was held that the covenant was not in violation of the federal statute: "It was clearly aimed at the so-called 'trusts' or monopolies now so familiar in this country, whose main object was the restraint of trade. The intention was undoubtedly to declare every contract illegal which was in the line of these evils. But it certainly was not intended to prohibit a man from selling his business in the ordinary way and from thereupon obtaining the full value thereof, through the instrumentality of an incidental covenant not to compete with the purchaser within some limited area."

*Compare Monongahela River Coal, etc. Co. v. Jutte*, 210 Pa. St. 288 (1904), (59 Atl. Rep. 1088, 105 Am. St. Rep. 812).

Where a corporation in the fish business sold out its property and good-will, and its stockholders, who dealt in fish at different places, agreed not to enter into competition with the purchaser for a period of ten years it was held that the agreement was not in violation of the federal statute.

*Davis v. Booth*, 127 Fed. 875 (1904), *affirmed* 131 Fed. 31 (1904).

<sup>2</sup> *Shawnee Compress Co. v. Anderson*, 28 Sup. Ct. Rep. 572 — decided by U. S. Supreme Court, April, 1908.

In this case a corporation sought to obtain control of the business of compressing cotton in a certain territory by purchasing or leasing local plants. It exacted from a lessor an agreement not to engage in the compress business for a specified period within fifty miles of any of its plants and to render "every assistance in discouraging unreasonable and unnecessary competition." The Supreme Court of Oklahoma (17 Okl. 231 (1906), (87 Pac. Rep. 315)) held the contract void and the U. S. Supreme Court affirmed its decision.

Where a contract for the sale of a business contained an agreement that the vendor for a specified period should not engage in a competing business, and it appeared that the agreement was obtained as a part of a scheme to form an illegal combination by which a monopoly of a particular business was obtained, it was

**§ 388. Statute not limited to Unreasonable Restraint of Trade.**

—The meaning of the phrase “contract in restraint of trade” has never been confined to contracts in *unreasonable* restraint of trade. As already shown, contracts to which the phrase in its primary sense was applicable were valid at common law if reasonable; invalid, if unreasonable.<sup>1</sup> But in each case they were called “contracts in restraint of trade.” So, using the phrase in its more modern sense as equivalent to “agreement restraining competition,” its application has never been dependent upon the invalidity of the contract. And, equally true, the test of the legality of the contract has not been whether it was in restraint of trade, but whether the restraint had been carried so far as to be injurious.

After the enactment of the federal anti-trust statute it was contended that it applied only to contracts in unreasonable restraint of trade, and this contention was sustained in several decisions of the lower federal courts.<sup>2</sup> But when the question came before the Supreme Court of the United States that Court pointed out that the phrase “contract in restraint of trade” applied equally well to contracts lawful and unlawful at common law and was used in the statute without qualification. Thus the Court said in the *Trans-Missouri Freight Association Case*:<sup>3</sup> “By the simple use of the term ‘contract in restraint

held that the agreement was in violation of the federal statute.

*McConnell v. Camors-McConnell Co.*, 152 Fed. 321 (1907).

<sup>1</sup> See *ante*, Ch. XXXIII: “*Application of Law of Contracts in Restraint of Trade.*”

<sup>2</sup> *Prescott, etc. R. Co. v. Atchison, etc. R. Co.*, 73 Fed. 438 (1896); *Dueber Watch Case Mfg. Co. v. Howard Watch, etc. Co.*, 66 Fed. 637 (1895); *In re Greene*, 52 Fed. 104 (1892); *In re Nelson*, 52 Fed. 647 (1892).

<sup>3</sup> *United States v. Trans-Missouri Freight Ass’n*, 166 U. S. 328 (1897), (17 Sup. Ct. Rep. 540). In reaching the conclusion stated in the text Mr. Justice Peckham said: “It is now with much amplification of

argument urged that the statute, in declaring illegal every combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce, does not mean what the language used plainly imports, but that it only means to declare illegal any such contract which is in *unreasonable* restraint of trade, while leaving all others unaffected by the provisions of the act; that the common law meaning of the term ‘contract in restraint of trade’ includes only such contracts as are in unreasonable restraint of trade, and when that term is used in the federal statute, it is not intended to include all contracts in restraint of trade, but only those which are in unreasonable restraint thereof. The term

of trade' all contracts of that nature, whether valid or otherwise, would be included, and not alone that kind of contract which was invalid and unenforceable as being in unreasonable restraint of trade. When, therefore, the body of an act pronounces as illegal every contract or combination in restraint of trade or commerce among the several States, etc., the plain and ordinary meaning of such language is not limited to that kind of contract alone which is in unreasonable restraint of trade, but all contracts are included in such language, and no exception or limitation can be added without placing in the act that which has been omitted by Congress."

The statute, therefore, makes every contract or combination in restraint of interstate trade or commerce, without limitation or qualification, illegal. The extent of the restraint imposed is immaterial. The essential question in every case is whether the contract under consideration directly imposes any restraint whatsoever. If it does, no matter how slight, it comes within the prohibition of the statute.<sup>1</sup>

is not of such limited signification. Contracts in restraint of trade have been known and spoken of for hundreds of years, both in England and this country, and the term includes all kinds of those contracts which in fact restrain or may restrain trade. Some of such contracts have been held void and unenforceable in the courts by reason of their restraint being unreasonable, while others have been held valid because they were not of that nature. A contract may be in restraint of trade and still be valid at common law. Although valid, it is nevertheless a contract in restraint of trade and would be so described either at common law or elsewhere."

Mr. Justice White delivered an elaborate dissenting opinion in this case, concurred in by Justices Field, Gray and Shiras, in which he reached the conclusion that the act applied only to contracts in *unreasonable* restraint of trade.

<sup>1</sup> In *Shawnee Compress Co. v.*

*Anderson*, 28 Sup. Ct. Rep. 572, decided by the Supreme Court April, 1908, the Court said: "The Sherman law provides that, 'Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any territory of the United States or of the District of Columbia . . . is hereby declared illegal.' And it has been decided that not only unreasonable, but all direct, restraints of trade are prohibited, the law being thereby distinguished from the common law."

*Northern Securities Co. v. United States*, 193 U. S. 331 (1904), (24 Sup. Ct. Rep. 436): "The act is not limited to restraints of interstate and international trade or commerce that are unreasonable in their nature, but embraces *all* direct restraints imposed by any combination, conspiracy or monopoly upon such trade or commerce."

In *Pocahontas Coke Co. v. Powhatan Coal, etc. Co.*, 60 W. Va. 508 (1907), (56 S. E. Rep. 270, 116 Am.



This construction of the statute gives it the broadest possible application. It includes contracts and combinations perfectly

St. Rep. 901, 10 L. R. A. (N.S.) 268), the Court said: "It may be said in this connection that the determination of the question whether or not a contract in restraint of trade is to be arrived at in exactly the same way and under exactly the same rules whether the case falls under the act of Congress or under the rules of the common law. The difference between the act and the common law does not lie in the manner of ascertaining whether or not restraint exists but in the degree of restraint required to make the contract illegal. Under the act of Congress any restraint is illegal while under the common law only unreasonable restraint is illegal."

Prior to the decision in the *Trans-Missouri* case agreements by dealers to purchase all of a certain product used by them from a producer controlling the greater part of such product, in consideration of rebates, had been held not to be contracts in restraint of trade within the meaning of the federal statute. *United States v. Greenhut*, 51 Fed. 213 (1892). *In re Corning*, 51 Fed. 205 (1892); *In re Terrill*, 51 Fed. 213 (1892); *In re Greene*, 52 Fed. 104 (1892).

But such agreements would now undoubtedly be held to violate the statute. Agreements of somewhat similar nature have repeatedly been held to be contracts in restraint of trade in violation of the statute. Thus in *Montague v. Lowry*, 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307), *affirming* 115 Fed. 27 (1902), the Supreme Court held an agreement creating an association between manufacturers and dealers in tiles, whereby the latter agreed not to purchase materials from manufacturers not members, and not to sell unset tiles to any one other than members except at much higher prices than to

members, and whereby the manufacturers agreed to sell only to dealers who were members, to be a contract in restraint of trade in contravention of the statute. So an agreement between a corporation and a number of producers of coal and coke constituting an association, whereby the former agrees to take the entire output of such producers intended for "Western shipment"; to sell the same at prices fixed by the executive committee of the association; to account for the proceeds above a fixed compensation and to refrain from selling the product of any competing producer, and whereby the amount to be furnished by such producer is also fixed by such executive committee — each producer receiving payment at the same rate — has been held to be a contract in restraint of trade contrary to the federal statute. *Chesapeake, etc. Fuel Co. v. United States*, 115 Fed. 610 (1902), *affirming* 105 Fed. 93 (1900). It was also held in this case that it was no defence to an action upon the statute that the combination had not operated injuriously to the public, or even that, by opening up a wider field for competition, its operation had actually been beneficial to the public.

An agreement between the wholesale dealers in window glass controlling a large part of the business in that article in the United States and a manufacturer producing the greater part of such article sold in this country whereby the dealers agree to buy wholly from the manufacturer — except at materially reduced prices — and the manufacturer agrees to sell only to the dealers — except at materially enhanced prices — and which fixes the amount to be received by each dealer and the prices at which

valid according to rules of public policy. It undoubtedly renders unlawful agreements which would actually be beneficial to the public. An amendment to the statute relaxing its provisions and making it applicable only to contracts and combinations in unreasonable restraint of trade has been urged by the highest authority. It cannot be denied, however, that such an amendment would necessarily deprive the statute of

the glass is to be sold, is a contract in restraint of trade in conflict with the federal statute.

*Wheeler-Stenzel Co. v. National Glass Jobbers' Ass'n*, 152 Fed. 864 (1907).

See also *United States v. Joint Traffic Ass'n*, 171 U. S. 505 (1898), (19 Sup. Ct. Rep. 25); *United States v. Swift*, 122 Fed. 529 (1903), *modified and affirmed* 196 U. S. 375 (1905), (25 Sup. Ct. Rep. 276); *United States v. Coal Dealers Ass'n*, 85 Fed. 261 (1898); *Getz v. Federal Salt Co.*, 147 Cal. 115 (1905), (81 Pac. Rep. 416, 109 Am. St. Rep. 114). Compare the agreements in these cases with the contract in *Ceballos v. Munson Steamship Line*, 93 App. Div. (N. Y.) 593 (1904), (87 N. Y. Supp. 811).

A contract by which a corporation agreed to buy all its materials from, and sell all its manufactured products to, another corporation, however, has been held not to violate the federal statute.

*Heimbucher v. Goff*, 119 Ill. App. 373 (1905).

And a contract by which a manufacturer agreed to sell his entire output to a party who agreed to take it at a specified price and to purchase such product from no other person in the State has been held, under the circumstances, to foster legitimate business and not to violate the federal statute. *Lanyon v. Garden City Sand Co.*, 223 Ill. 616 (1906), (79 N. E. Rep. 313).

In its opinion in this case (p. 621) the Court said of the federal and the Illinois anti-trust statutes: "The

object of these statutes, is to prohibit the formation of trusts and combinations and remove all obstructions in restraint of trade and free competition. It is not the purpose of either law to hinder or prohibit contracts on the part of corporations or individuals made to foster or increase trade or business. But a contract may incidentally restrain competition or trade without violating the statutes if its chief purpose is to promote and increase the business of those who enter into it."

This decision is, of course, decisive as to the purposes of the Illinois statute, but it seems quite at variance with the decisions of the Supreme Court interpreting the federal statute as applying to *all* contracts restraining competition whether reasonable or unreasonable.

When it is claimed that a combination is in violation of the federal anti-trust statute it is immaterial that the agreement in question might have been valid at common law.

*Continental Wall Paper Co. v. Voight*, 148 Fed. 939 (1906).

The combination in this case, however, which was by means of a corporation selling agent, would seem to have been illegal at common law.

In determining whether a contract or combination is in restraint of trade within the meaning of the statute the test is whether it directly restrains trade to an appreciable extent, and it is immaterial what other results may flow from it.

*Ellis v. Inman*, 131 Fed. 182 (1904).

much of its effectiveness. Contracts and combinations in unreasonable restraint of trade were unlawful at common law. If the act be amended to apply only to combinations of this character it will merely have the effect of imposing additional penalties for existing offences, besides bringing for determination into every case that most uncertain of questions — what is an unreasonable restraint of trade or commerce?

While the discussion of economic questions is outside the scope of this treatise, it is suggested that a solution of the difficulty might be found in an amendment which, while preserving the presumptive application of the statute, would permit a defendant combination to avoid the operation of the act by showing affirmatively that its objects and methods are not of a nature injurious to the public.<sup>1</sup>

§ 389. Use of Terms “Monopolize” and “Monopolies.” — The second section of the federal anti-trust statute provides that “every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize” any part of interstate commerce shall be guilty of a misdemeanor. The statute is entitled “An act to protect trade and commerce from unlawful restraints and monopolies.”

These words — the verb “monopolize” in the body of the act and the noun “monopolies” in the title — manifestly have no reference to governmental grants of privileges, and are

<sup>1</sup> Mr. Justice Brewer, although concurring in the decision of the *Trans-Missouri* case, said in his opinion in the *Northern Securities* case (193 U. S. 361 (1904), (24 Sup. Ct. Rep. 436)): “Instead of holding that the anti-trust act included all contracts, reasonable or unreasonable, in restraint of interstate trade, the ruling should have been that the contracts there presented were unreasonable restraints of interstate trade, and as such within the scope of the act. That act, as appears from its title, was levelled at only ‘unlawful restraints and monopolies.’ Congress did not intend to reach and

destroy those minor contracts in partial restraint of trade which the long course of decisions at common law had affirmed were reasonable and ought to be upheld. The purpose rather was to place a statutory prohibition with prescribed penalties and remedies upon those contracts which were in direct restraint of trade, unreasonable and against public policy. Whenever a departure from common law rules and definitions is claimed, the purpose to make the departure should be closely shown. Such a purpose does not appear and such a departure was not intended.”

used in the broad sense which we have seen now attaches to the word "monopoly."<sup>1</sup>

In formulating the rules of public policy it was unnecessary to do more than describe a monopoly as "*the concentration of business in the hands of a few.*" But this description while giving a broad idea of the meaning of the term is not sufficiently definite for use in construing a statute of this nature. A precise definition, however, is difficult to frame. The exact boundaries of monopoly are not readily located. An attempt, therefore, will only be made to describe that which *certainly* comes within the meaning of the term as used in the federal statute.

The following language of Mr. Justice McKenna in the recent *Case of the National Cotton Oil Company*<sup>2</sup> furnishes the most authoritative basis for such a description: "It is certainly the conception of a large body of public opinion that the control of prices through a combination tends to restraint of trade and to monopoly, and is evil. The foundations of the belief we are not called upon to discuss, nor does our purpose require us to distinguish between the kinds of combinations or the degrees of monopoly. It is enough to say that the idea of monopoly is not now confined to a grant of privileges. It is understood to include a condition produced by the acts of mere individuals. Its dominant thought now is, to quote another, 'the notion of exclusiveness or unity,' in other words, the suppression of competition by the unification of interest or management, or, it may be, through agreement and concert of action. And the purpose is so definitely the control of prices that monopoly has been defined to be 'unified tactics with regard to prices.' It is the power to control prices which makes the inducement of combinations and their profit. It is such power that makes it the concern of the law to prohibit or limit them. And this concern and the policy based upon it has not only expression in the Texas statutes; it has expression in the statutes of other States and in a well-known national enactment. According to them, competition, not combination, should be the law of trade. If there is evil in this it is accepted as less

<sup>1</sup> See *ante*, § 332: "*Modern Use of Term 'Monopoly.'*"

<sup>2</sup> *National Cotton Oil Co. v. Texas*,

197 U. S. 129 (1905), (25 Sup. Ct. Rep. 379).

than that which may result from the unification of interest, and the power such unification gives."

From this opinion and the definitions found in other cases, as stated in the footnote,<sup>1</sup> it may conservatively be said that

<sup>1</sup> In *American Biscuit, etc. Co. v. Klotz*, 44 Fed. 724 (1891), the Court thus discussed the meaning of the word "monopolize," as used in the federal anti-trust law and in the Louisiana statute: "In construing the federal and State statutes, we exclude from consideration all monopolies which exist by legislative grant; for we think the word 'monopolize' cannot be intended to be used with reference to the acquisition of exclusive rights under government concession, but that the law-maker has used the word to mean 'to aggregate' or 'concentrate' in the hands of a few, practically, and, as a matter of fact, and according to the known results of human action, to the exclusion of others; to accomplish this end by what, in popular language is expressed in the word 'pooling,' which may be defined to be an aggregation of property or capital belonging to different persons, with a view to common liabilities and profits. . . . One just and decisive test of the meaning of the expression 'to monopolize,' is obtained by getting at the evil which the law-maker has endeavored to abolish and restrict. The statutes show that the evil was the hindrance and oppression in trade and commerce wrought by its absorption in the hands of the few, so that the prices would be in danger of being arbitrarily and exorbitantly fixed, because all competition would be swallowed up, so that the man of small means would find himself excluded from the restrained or monopolized trade or commerce as absolutely as if kept out by law or force."

*In re Greene*, 52 Fed. 115 (1892): "A 'monopoly,' in the prohibited

sense, involves the element of an exclusive privilege or grant which restrained others from the exercise of a right or liberty which they had before the monopoly was secured. In commercial law, it is the abuse of free commerce, by which one or more individuals have procured the advantage of selling alone or exclusively all of a particular kind of merchandise or commodity to the detriment of the public. As defined by Blackstone (4 Bl. Com. 159), and by Lord Coke (3 Co. Inst. 181), it is a grant from the sovereign power of the State by commission, letters patent, or otherwise, to any person or corporation, by which the exclusive right of buying, selling, making, working, or using anything is given. When this section of the act was under consideration in the Senate, distinguished members of its judicial committee and lawyers of great ability explained what they understood the term 'monopoly' to mean; one of them saying: 'It is the sole engrossing to a man's self by means which prevent other men from engaging in fair competition with him.' Another senator defined the term in the language of Webster's Dictionary: 'To engross or obtain, by any means, the exclusive right, especially of the right of trading, to any place or with any country or district; as to monopolize the India or Levant trade.' It will be noticed that, in the foregoing definitions of 'monopoly,' there is embraced two leading elements, viz., an exclusive right or privilege, on the one side, and a restriction or restraint on the other, which will operate to prevent the exercise of a right or liberty open to the public before the monopoly was secured. This being, as we think,

trade and commerce are "monopolized" within the meaning of the second section of the federal statute when, as a result of efforts to that end, previously competing businesses are so concentrated in the hands of a single person or corporation, or a few persons or corporations acting together, that they have power to practically control the prices of a commodity and thus to practically suppress competition.

It is not necessary, however, to constitute a violation of the act that the result of the concentration of business should be a complete monopoly, nor that it should have resulted in actual injury to the public. The essential question is one of *power*.<sup>1</sup>

The second section of the act, so far as it relates to combinations to monopolize, only includes offences already covered

the general meaning of the term, as employed in the second section of the statute, an 'attempt to monopolize' any part of the trade or commerce among the States must be an attempt to secure or acquire an exclusive right in such trade or commerce by means which prevent or restrain others from engaging therein."

United States v. Trans-Missouri Association, 58 Fed. Rep. 82 (1892): "A monopoly of trade embraces two essential elements: (1) The acquisition and exclusive right to, or exclusive control of, a trade; and (2) the exclusion of all others from that right and control."

United States v. Patterson, 55 Fed. Rep. 640 (1893): "The second section is limited by its terms to monopolies, and evidently has as its basis the engrossing or controlling of the market. The first section is undoubtedly *in pari materia*, and so has as its basis the engrossing or controlling of the market, or of lines of trade."

<sup>1</sup> United States v. E. C. Knight Co., 156 U. S. 16 (1895), (15 Sup. Ct. Rep. 249): "Again, all authorities agree that in order to vitiate a contract or combination it is not essential that its result should be a complete

monopoly; it is sufficient if it really tends to that end and to deprive the public of the advantages which flow from free competition."

United States v. Chesapeake, etc. Fuel Co., 105 Fed. 104 (1900), *affirmed* 115 Fed. 610 (1902): "All competition among the members of the association in the production, shipment, and sale of their product is eliminated, and the combination enters the Western markets clothed with powers which enable it to exercise a large influence in those markets in regulating the supply and the prices of coal and coke. These provisions are in restraint of trade, and tend to monopoly, within the meaning of the act of Congress, and render the contract illegal, in so far as it relates to interstate commerce. The important question is not whether the performance of the contract so far has resulted in actual injury to trade, but whether the contract confers power to regulate and restrain trade, upon those charged with its performance."

As indicated by the language of the last decision the principles there stated are equally applicable to combinations in restraint of trade under the first section of the act.

by the first section. A combination or conspiracy to monopolize trade is a combination or conspiracy in restraint of trade. So actually monopolizing trade by different persons acting in concert is undoubtedly a combination in restraint of trade. Practically all that is reached by the second section of the act not embraced by the first section — other than attempts to monopolize — is the monopolizing of trade and commerce by a *single* person or corporation.<sup>1</sup> But in the case of a corporate combination this distinction between the two sections might be of the utmost importance.

To constitute an attempt to monopolize within the meaning of the second section an intent to create a monopoly must be shown.<sup>2</sup>

<sup>1</sup> In his dissenting opinion in Northern Securities case, 193 U. S. 404 (1904), (24 Sup. Ct. Rep. 436) Mr. Justice Holmes said: "All that is added to the first section by section 2 is that the penalties are imposed upon every single person who, without combination, monopolizes or attempts to monopolize commerce among the States, and that the liability is extended to attempting to monopolize any part of such trade or commerce. It is more important as an aid to the construction of section 1 than it is on its own account. It shows that whatever is criminal when done by way of combination is equally criminal if done by a single man."

<sup>2</sup> *Swift v. United States*, 196 U. S. 396 (1905), (25 Sup. Ct. Rep. 276): "Intent is almost essential to such a combination and is essential to such an attempt. Where acts are not sufficient in themselves to produce a result which the law seeks to prevent — for instance, the monopoly — but require further acts in addition to the mere forces of nature to bring that result to pass, an intent to bring it to pass is necessary in order to produce a dangerous probability that it will happen."

In *Whitwell v. Continental Tobacco Company*, 125 Fed. Rep. 462

(1903) the Court said concerning "attempts" to monopolize: "It is admitted that the practice of the defendants was not only an attempt, but a successful attempt, to monopolize a part of this commerce. But is every attempt to monopolize any part of interstate commerce made unlawful and punishable by section 2 of the Act of July 2, 1890?"

. . . If so, no interstate commerce has ever been lawfully transacted since that Act became a law, because every sale and every transportation of an article which is the subject of interstate commerce is a successful attempt to monopolize that part of this commerce which concerns that sale or transaction. An attempt by each competitor to monopolize a part of interstate commerce is the very root of all competition therein. Eradicate it, and competition necessarily ceases — dies. Every person engaged in interstate commerce necessarily attempts to draw to himself, and to exclude others from, a part of that trade; and, if he may not do this, he may not compete with his rivals; all other persons and corporations must cease to secure for themselves any part of the commerce among States, and some single corporation or person must be per-

§ 390. **Meaning of Phrase "Trade or Commerce among the Several States."** — The use of both the terms "trade" and "commerce" in the statute — especially disjunctively — indicates a belief on the part of the framers of the act that a wider commercial field was thereby covered than by the use of the term "commerce" alone. Such is not the case. The word "trade" is used in the sense of traffic and, broadly speaking, all traffic is commerce, although all commerce is not traffic.<sup>1</sup> In the often quoted words of Chief Justice Mar-

mitted to receive and control it all in one large monopoly."

It by no means follows, however, because a single purchase has so slight an effect upon commerce that it could not be described as an attempt to monopolize commerce, that a large number of purchases directed toward a common end might not, in the aggregate, be properly so designated.

<sup>1</sup> In *United States v. Debs*, 64 Fed. 751 (1894), Judge Woods said in reference to the federal statute: "I am unable to regard the word 'commerce,' in this statute, as synonymous with 'trade,' as used in the common law phrase 'restraint of trade.' In its general sense, trade comprehends every species of exchange or dealing, but its chief use is 'to denote the barter or purchase and sale of goods, wares, and merchandise, either by wholesale or retail,' and so it is used in the phrase mentioned. But 'commerce' is a broader term. It is the word in that clause of the constitution by which power is conferred on Congress 'to regulate commerce with foreign nations, and among the several States, and with the Indian Tribes.' Const. U. S., Art. I, § 8. In a broader and more distinct exercise of that power than ever before asserted Congress passed the enactments of 1887 and 1888 known as the 'Interstate Commerce Law.' The present statute is another exercise of that constitutional power, and the word

'commerce,' as used in that statute, as it seems to me, need not and should not be given a meaning more restricted than it has in the Constitution. . . These definitions and expositions of the scope and law of interstate commerce, except the last, preceded the enactment by Congress on the subject. It was therefore of commerce so defined, embracing all instrumentalities and subjects of transportation among the States, that Congress, by that legislation, assumed the control; and I see no reason for thinking that, as employed in the act of 1890, which is essentially supplemental to the other acts, the word was intended to be less comprehensive."

In *In re Debs*, 158 U. S. 564 (1895), (15 Sup. Ct. Rep. 900), the Supreme Court of the United States did not pass upon the question considered by Judge Woods in reference to the anti-trust act.

With reference to the provision in the Texas anti-trust statute making unlawful combinations to "create or carry out restrictions in trade," the Court in *Queen Ins. Co. v. State* (Tex. 1893), 22 S. W. Rep. 1048, said: "In ordinary language the word 'trade,' is employed in three different senses: First, in that of the business of buying and selling; second, in that of an occupation generally; and, third, in that of a mechanical employment in contra-distinction to agriculture and the liberal



shall in the first interstate commerce case:<sup>1</sup> "Commerce, undoubtedly, is traffic, but it is something more: it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches, and is regulated by prescribing rules for carrying on that intercourse."

The use of the word "trade" brings in the phrase "contract in restraint of trade" and makes available in the interpretation of the statute the established law regarding such contracts. But still, the phrase is used as an equivalent — so far as it goes — for "contract in restraint of commerce." The word "trade," in legal effect, adds nothing to the act. It covers nothing not embraced by the word "commerce"; and if it did, the act would be unconstitutional. Congress has power to regulate commerce. It may regulate trade only if trade is commerce. The phrase "trade or commerce among the several States" means *interstate commerce* — nothing more nor less.

Interstate commerce consists of intercourse and traffic between citizens or inhabitants of different States, and includes the purchase, sale and exchange of commodities, and the transportation of persons and property.<sup>2</sup>

arts. Ordinarily, when we speak of 'trade,' we mean commerce, or something of that nature; when we speak of 'a trade,' we mean an occupation in the more general or the limited sense."

<sup>1</sup> *Gibbons v. Ogden*, 9 Wheat. (U. S.) 189 (1824).

<sup>2</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 241 (1899), (20 Sup. Ct. Rep. 96) (*per Peckham, J.*): "As has frequently been said, interstate commerce consists of intercourse and traffic between the citizens or inhabitants of different States, and includes not only the transportation of persons and property and the navigation of public waters for that purpose, but also the purchase, sale and exchange of commodities."

*Hopkins v. United States*, 171 U. S. 597 (1898), (19 Sup. Ct. Rep. 40), (also *per Peckham, J.*): "Defi-

nitions as to what constitutes interstate commerce are not easily given so that they shall clearly define the full meaning of the term. We know from the cases decided in this court that it is a term of very large significance. It comprehends, as it is said, intercourse for the purposes of trade in any and all its forms, including transportation, purchase, sale and exchange of commodities between the citizens of different States, and the power to regulate it embraces all the instruments by which such commerce may be conducted."

See also *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249); *Hooper v. California*, 155 U. S. 653 (1895), (15 Sup. Ct. Rep. 207); *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196 (1885), (5 Sup. Ct. Rep. 826); *County of Mobile v. Kimball*, 102 U. S. 691 (1880).

But in considering the application of the statute it must be clearly borne in mind that "commerce among the States is not a technical legal conception but a practical one drawn from the course of business." Thus of traffic in cattle the Supreme Court of the United States has said: "When cattle are sent for sale from a place in one State with the expectation that they will end their transit, after purchase, in another, and when in effect they do so, with only the interruption necessary to find a purchaser at the stock yards, and when this is a typical, constantly recurring course, the current thus existing is a current of commerce among the States, and the purchase of the cattle is a part and incident of such commerce."<sup>1</sup>

§ 391. **Statute applies only to Restraints upon Interstate or International Commerce.**—The statute declares all contracts, combinations and conspiracies "in restraint of trade or commerce among the several States, or with foreign nations," illegal. It deals only with restraints upon those forms of commerce which Congress has power to regulate and, in law, as upon its face, is applicable only to contracts, combinations or conspiracies, in restraint of, or for the purpose of monopolizing, *interstate or international* commerce.<sup>2</sup>

In *In re Greene*, 52 Fed. 113 (1892), Judge Jackson said: "Commerce among the States, within the exclusive regulating power of Congress, consists of intercourse and traffic between their citizens, and includes the transportation of persons and property, as well as the purchase, sale, and exchange of commodities. . . . In the application of this comprehensive definition, it is settled by the decisions of the Supreme Court that such commerce includes, not only the actual transportation of commodities and persons between the States, but also the instrumentalities and processes of such transportation. That it includes all the negotiations and contracts which have for their object, or involve, as an element thereof, such transmission or passage from one State to another."

<sup>1</sup> *Swift v. United States*, 196

U. S. 399 (1905), (25 Sup. Ct. Rep. 276).

<sup>2</sup> *Field v. Barber Asphalt Paving Co.*, 194 U. S. 618 (1904), (24 Sup. Ct. Rep. 784); *Montague v. Lowry*, 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307); *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 211 (1899), (20 Sup. Ct. Rep. 96); *United States v. Joint Traffic Ass'n*, 171 U. S. 558 (1898), (19 Sup. Ct. Rep. 25); *Hopkins v. United States*, 171 U. S. 558 (1898), (19 Sup. Ct. Rep. 40); *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540); *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249); *Dueber Watch-Case Mfg. Co. v. Howard Watch, etc. Co.*, 66 Fed. 639 (1895); *National Distilling Co. v. Cream City Importing Co.*, 86 Wis. 352 (1893), (56 N. W. Rep. 864, 39 Am. St. Rep. 902).

In *Hopkins v. United States*<sup>1</sup> the Supreme Court of the United States said: "The act has reference only to that trade or commerce which exists, or may exist, among the several States or with foreign nations, and has no application whatever to any other trade or commerce."

§ 392. **Restraint upon Interstate Commerce must be Direct** — (A) **In General.** — There are few commercial contracts or combinations which cannot be said to have, indirectly or remotely, some bearing upon interstate commerce and, possibly, to restrain it. Private enterprises may be carried on by means of interstate shipments. Articles may be manufactured which the manufacturer intends to sell in another State. Combinations may be formed which result in enhancing the cost of conducting an interstate business. These agreements, and others of a similar nature which readily suggest themselves, may affect — and, perhaps, interfere with — interstate commerce without contravening the federal statute, because the restraint produced is not direct.<sup>2</sup>

But to render a contract unlawful as restraining interstate commerce it need not in terms refer to such commerce. It is sufficient if its real purpose and effect is to restrain commerce.

*Gibbs v. McNeeley*, 118 Fed. 120 (1902), reversing 107 Fed. 210 (1902).

<sup>1</sup> *Hopkins v. United States*, 171 U. S. 586 (1898), (19 Sup. Ct. Rep. 40).

<sup>2</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 246 (1899), (20 Sup. Ct. Rep. 96): "It is almost needless to add that we do not hold that every private enterprise which may be carried on, chiefly or in part, by means of interstate shipments, is, therefore, to be regarded as so related to interstate commerce as to come within the regulating power of Congress. Such enterprises may be of the same nature as the manufacturing of refined sugar in the *Knight Case* (*United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249)), — that is, the parties may be engaged as manufacturers of a commodity which they

thereafter intend at some time to sell, and, possibly, to sell in another State; but such sale, as we have already held, is an incident to and not the direct result of the manufacture, and so is not a regulation of, or an illegal interference with, interstate commerce."

*Hopkins v. United States*, 171 U. S. 592 (1898), (19 Sup. Ct. Rep. 40): "The contract condemned by the statute is one whose direct and immediate effect is a restraint upon that kind of trade or commerce which is interstate. . . . To treat as condemned by the act all agreements under which, as a result, the cost of conducting an interstate business may be increased would enlarge the application of the act far beyond the fair meaning of the language used. There must be some direct and immediate effect upon interstate commerce to come within the act. . . . Many agreements suggest themselves which relate only to facilities furnished commerce, or else touch it in an indirect

The statute must receive a reasonable construction,<sup>1</sup> and a combination or contract to fall within its provisions must

way, while possibly enhancing the cost of transacting the business, and which, at the same time, we would not think of as agreements in restraint of interstate trade or commerce. . . . An agreement may in a variety of ways affect interstate commerce just as State legislation may, and yet, like it, be entirely valid, because the interference produced by the agreement, or by the legislation, is not direct."

*Anderson v. United States*, 171 U. S. 615 (1898), (19 Sup. Ct. Rep. 50): "It has already been stated in the *Hopkins* case, above mentioned, that, in order to come within the provisions of the statute, the direct effect of an agreement or combination must be in restraint of that trade or commerce which is among the several States or with foreign nations."

*United States v. Joint Traffic Ass'n*, 171 U. S. 569 (1898), (19 Sup. Ct. Rep. 25): "The effect upon interstate commerce must not be indirect or incidental only. An agreement entered into for the purpose of promoting the legitimate business of an individual or corporation with no purpose to thereby affect or restrain commerce is not, as we think, covered by the act, although the agreement may indirectly and remotely affect that commerce."

See also *Montague v. Lowry*, 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307); *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540); *United States v. E. C. Knight Co.*, 156 U. S.

12 (1895), (15 Sup. Ct. Rep. 249); *Union Sewer Pipe Co. v. Connolly*, 99 Fed. 354 (1900); *affirmed* 184 U. S. 540 (1902), (22 Sup. Ct. Rep. 431); *United States v. Coal Dealers Ass'n*, 85 Fed. 252 (1898); *United States v. Chesapeake, etc. Fuel Co.*, 105 Fed. 93 (1900); *affirmed* 115 Fed. 610 (1902); *United States v. Jellico Mountain Coal, etc. Co.*, 46 Fed. 432 (1891).

In the very recent case of *Cincinnati Packet Co. v. Bay*, 200 U. S. 184 (1906), (26 Sup. Ct. Rep. 208) the Supreme Court said: "We will suppose then that the contract does not leave commerce among the States untouched. But even on this supposition it is manifest that interference with such commerce is insignificant and incidental and not the dominant purpose of the contract if it actually was thought of at all. . . . The chief and visible object of its provisions has nothing to do with commerce among the States. . . . We are of the opinion that the agreement before us is not made illegal by either of the provisions thus far discussed."

As shown in note to § 387, *ante*, the contract under consideration in *Cincinnati Packet Co. v. Bay*, *supra*, was an ancillary agreement by the vendors of certain steamboats to withdraw from the business of operating boats between two points on the Ohio River in the State of Ohio. It was not clearly shown that it was necessary to pass through any other State than Ohio in going from one point to the other, but the Court placed

<sup>1</sup> *Hopkins v. United States*, 171 U. S. 600 (1898), (19 Sup. Ct. Rep. 40): "The act of Congress must have a reasonable construction or else there would scarcely be an agreement

or contract among business men that could not be said to have, indirectly or remotely, some bearing upon interstate commerce and possibly to restrain it."

have some direct and immediate effect in restraint of commerce among the States. It is inapplicable to combinations whose effect upon interstate commerce is indirect or incidental only.

§ 393. **Restraint upon Interstate Commerce must be Direct — (B) Combinations relating to Manufacture and of Manufacturers and Producers.** — Manufacture is transformation. Commerce is intercourse.<sup>1</sup> "Commerce succeeds to manufacture and is not a part of it."<sup>2</sup> Reducing raw materials into finished products directly involves neither transportation nor traffic. Commerce — State and interstate — begins only when the process of manufacture is completed. The article produced,

its decision upon the broader ground that if interference with interstate commerce existed it was merely incidental and held that the federal anti-trust statute was inapplicable.

A specification in an ordinance, not invalid under the laws of a State, of a particular kind of asphalt produced only in a foreign country violates no federal right and contracts entered into thereunder are not within the federal anti-trust statute. The statute "is not intended to affect contracts which have a remote and indirect bearing upon commerce between the States."

*Field v. Barber Asphalt Paving Co.*, 194 U. S. 618 (1904), (24 Sup. Ct. Rep. 784).

<sup>1</sup> In *Kidd v. Pearson*, 128 U. S. 20 (1888), (9 Sup. Ct. Rep. 6), Mr. Justice Lamar said: "No distinction is more popular to the common mind, or more clearly expressed in economic and political literature, than that between manufacture and commerce. Manufacture is transformation — the fashioning of raw materials into a change of form for use. The functions of commerce are different. The buying and selling and the transportation incidental thereto constitute commerce; and the regulation of commerce in the constitutional sense embraces the regulation at least of

such transportation. . . . If it be held that the term includes the regulation of all such manufactures as are intended to be the subject of commercial transactions in the future, it is impossible to deny that it would also include all the productive industries that contemplate the same thing. The result would be that Congress would be invested, to the exclusion of the States, with the power to regulate, not only manufactures, but also agriculture, horticulture, stock raising, domestic fisheries, mining — in short, every branch of human industry. For is there one of them that does not contemplate, more or less clearly, an interstate or foreign market? Does not the wheat grower of the Northwest, and the cotton planter of the South, plant, cultivate and harvest his crop with an eye on the prices at Liverpool, New York and Chicago? The power being vested in Congress and denied to the States, it would follow as an inevitable result that the duty would devolve on Congress to regulate all of these delicate, multifarious, and vital interests — interests which in their nature are, and must be, local in all the details of their successful management."

<sup>2</sup> *United States v. E. C. Knight Co.*, 156 U. S. 12 (1895), (15 Sup. Ct. Rep. 249).

itself, becomes the subject of interstate commerce only when its transportation from one State to another commences.<sup>1</sup> The purpose and intent of the manufacturer in producing it do not determine when or whether it belongs to interstate commerce.<sup>2</sup>

Contracts for the sale and transportation across State lines of manufactured articles are proper subjects of regulation by Congress because they form part of interstate commerce. A combination, however, solely for the purpose of controlling *manufacture*, is not in violation of the federal statute because, upon principles already indicated, such a combination does not directly affect or restrain interstate commerce.<sup>3</sup> Even if such a combination directly affected commerce within a State it would not come within the provisions of the statute, for State commerce is a matter of State control. These principles are clearly stated in the opinion of Mr. Chief Justice Fuller in *United States v. E. C. Knight Company*:<sup>4</sup> "Doubtless the

<sup>1</sup> *In re Greene*, 52 Fed. 113 (1892), (Jackson, J.): "When commerce begins is determined not by the character of the commodity, nor by the intention of the owner to transfer it to another State for sale, nor by his preparation of it for transportation, but by its actual delivery to a common carrier for transportation, or the actual commencement of its transfer to another State. At that time the power and regulating authority of the States ceases, and that of Congress attaches and continues until it has reached another State, and becomes mingled with the general mass of property in the latter State. Neither the production nor manufacture of articles or commodities which constitutes subjects of commerce, and which are intended for trade and traffic with citizens of other States, nor the preparation for their transportation from the State where produced or manufactured prior to the commencement of the actual transfer or transmission thereof to another State, constitutes that interstate

commerce which comes within the regulating power of Congress; and, further, after the termination of the transportation of commodities or articles of traffic from one State to another, and the mingling or merging thereof in the general mass of property in the State of destination, the sale, distribution, and consumption thereof in the latter State forms no part of interstate commerce."

<sup>2</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 239 (1899), (20 Sup. Ct. Rep. 96); *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249).

<sup>3</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 239 (1899), (20 Sup. Ct. Rep. 96); *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249); *Dueber Watch Case Mfg. Co. v. Howard Watch, etc. Co.*, 66 Fed. 642 (1895); *Gibbs v. McNeeley*, 107 Fed. 211 (1901), *reversed* 118 Fed. 120 (1902); *Robinson v. Suburban Brick Co.*, 127 Fed. 804 (1904).

<sup>4</sup> *United States v. E. C. Knight*

power to control the manufacture of a given thing involves, in a certain sense, the control of its disposition, but this is the secondary and not the primary sense; and although the exercise of that power may result in bringing the operation of commerce into play, it does not control it, and affects it only incidentally and indirectly. . . . Contracts to buy, sell, or exchange goods to be transported among the several States, the transportation and its instrumentalities, and articles bought, sold, or exchanged for the purposes of such transit among the States, or put in the way of transit, may be regulated, but this is because they form part of interstate trade or commerce. The fact that an article is manufactured for export to another State does not of itself make it an article of interstate commerce, and the intent of the manufacturer does not determine the time when the article or product passes from the control of the State, and belongs to commerce."

When, however, the combination, although relating to manufacture — to *production* — goes further and restrains the *disposition* of the manufactured article and its distribution among several States, its direct and immediate effect is to restrain interstate commerce, and it comes within the prohibition of the statute. The distinction between combinations simply to control manufacture and production, and those embracing

Co., 156 U. S. 12 (1895), (15 Sup. Ct. Rep. 249). In this case it appeared that the American Sugar Refining Company, a New Jersey corporation, with authority to purchase, refine and sell sugar, had, prior to March, 1892, obtained control of all the sugar refineries in the United States excepting four in Philadelphia, including the E. C. Knight Company, and one, of small capacity, in Boston, with all of which it was in active competition; that, in March, 1892, the American Sugar Refining Company entered into contracts with the stockholders of each of the Philadelphia corporations whereby it purchased their stock with its own stock; and thereby acquired possession of the Philadelphia refineries and business;

that there was no concerted action between the stockholders of the companies, but each company acted independently of each other; that the contracts of sale left the vendors free to engage in the same business; that the object in purchasing the Philadelphia refineries was to obtain more perfect control over the business of refining and selling sugar in the United States.

Bill filed by the United States, against E. C. Knight Company charging violation of federal anti-trust act was dismissed by Circuit Court (60 Fed. 306 (1894)); decree affirmed by Circuit Court of Appeals for Third Circuit (60 Fed. 934 (1894)), and by Supreme Court of the United States in the decision above cited.

the additional purpose of controlling disposition and distribution, is pointed out by the Supreme Court of the United States in *Addyston Pipe, etc. Company v. United States*,<sup>1</sup> where the combination under consideration is distinguished from that involved in the *Knight* case. Mr. Justice Peckham said: "The direct purpose of the combination in the *Knight* case was the control of the manufacture of sugar. There was no combination or agreement, in terms, regarding the future disposition of the manufactured article; nothing looking to a transaction in the nature of interstate commerce. The probable intention on the part of the manufacturer of the sugar to thereafter dispose of it by sending it to some market in another State, was held to be immaterial and not to alter the character of the combination. . . . The case was decided upon the principle that a combination simply to control manufacture was not in violation of the act of Congress, because such contract or combination did not directly control or affect interstate commerce, but that contracts for the sale and transportation to another State of specific articles were proper subjects of regulation, because they did form part of such commerce. We think the case now

<sup>1</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 240 (1899), (20 Sup. Ct. Rep. 96).

In this case, it appeared that six corporations, manufacturing iron pipe in several different States, formed an association whereby the territory in which they principally operated, comprising a large part of the United States, was divided into "reserved" cities and "pay territory." The reserved cities were allotted to certain members of the association, free from competition, although the other members agreed to stimulate competition by putting in higher bids.

In the pay territory all offers to purchase pipe were submitted to a committee which fixed the price and awarded the contract by an "auction pool" — the members of the association agreeing to pay the largest bonus to be divided among the others receiving the contract. In the "free

territory" there were no restrictions upon competition.

Bill by the United States against the Addyston Pipe and Steel Company and the other members of the association, charging a violation of the federal anti-trust act, was dismissed by the trial court (78 Fed. 712 (1897)), but, upon appeal to the Circuit Court of Appeals for the Sixth Circuit, Judge Taft delivering an able and elaborate opinion (*United States v. Addyston Pipe, etc. Co.*, 85 Fed. 271 (1898)), the judgment was reversed, with instructions to enter a decree perpetually enjoining the defendants from maintaining or doing any business under said combination. Upon appeal to the Supreme Court of the United States, this decree, modified and limited to that portion of the combination which was interstate in character, was affirmed.



before us involves contracts of the nature last mentioned, not incidentally or collaterally, but as a direct and immediate result of the combination engaged in by the defendants. . . . If, therefore, an agreement or combination directly restrains, not alone the manufacture, but the purchase, sale or exchange of the manufactured commodity among the several States, it is brought within the provisions of the statute. The power to regulate such commerce, that is, the power to prescribe the rules by which it shall be governed, is vested in Congress, and when Congress has enacted a statute such as the one in question, any agreement or combination which directly operates, not alone upon the manufacture, but upon the sale, transportation and delivery of an article of interstate commerce, by preventing or restricting its sale, etc., thereby regulates interstate commerce to that extent, and to the same extent trenches upon the power of the national legislature and violates the statute."

It follows, therefore, from these principles that there is a marked distinction between a combination relating to *manufacture* and a combination of *manufacturers*. The former falls without the statute because it can affect interstate commerce only indirectly. The latter may be of wider scope and contravene the statute by directly restraining interstate commerce. In fact, Mr. Justice Harlan in the *Northern Securities Case*<sup>1</sup> states as settled "that combinations even among private manufacturers or dealers whereby interstate or international commerce is restrained are equally embraced by the act."

Combinations or agreements between manufacturers or producers in which an attempt is made to directly control the disposition of the manufactured article or product are within the statute. Thus, as we have seen, where the combination directly restrains not only manufacture, but the sale and the transportation of the manufactured product across State lines it is violation of the act.<sup>2</sup> So, the statute applies to a combination between manufacturers in one State and dealers in another State relating to the purchase and sale of a manufactured

<sup>1</sup> *Northern Securities Co. v. United States*, 193 U. S. 331 (1904), (24 Sup. Ct. Rep. 436). See *post*, § 397a: "*The Northern Securities Case.*"

<sup>2</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 239 (1899), (20 Sup. Ct. Rep. 96), *supra*.

article.<sup>1</sup> Indeed, the recent decisions of the Supreme Court of the United States seem to warrant the broad statement that *any combination of manufacturers, producers or dealers the direct object of which is to place restraints upon, or to monopolize, interstate commerce is in contravention of the federal statute.*<sup>2</sup>

<sup>1</sup> In *Montague v. Lowry*, 193 U. S. 38, 47 (1904), (24 Sup. Ct. Rep. 307), the Supreme Court said: "The purchase and sale of tiles between the manufacturers in one State and dealers therein in California was interstate commerce within the *Addyston Pipe case*, 175 U. S. 239 (1899), (20 Sup. Ct. Rep. 90). It was not a combination among manufacturers simply but one between them and dealers in the manufactured article, which was an article of commerce between the States. *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249) did not therefore cover it."

In *Montague v. Lowry*, *supra*, an association had been formed in California by manufacturers of, and dealers in, tiles and mantels. The dealers who resided in California agreed to purchase materials only from manufacturers who were members and not to sell unset tiles to any one other than members except at materially higher prices than to the members. The manufacturers resided in other States than California and agreed not to sell to any persons not members. The action which reached the Supreme Court was brought for the recovery of damages under the federal anti-trust statute. The Court held that, although some of the transactions covered by the combination agreement were of a local nature, the scheme as a whole constituted a combination in restraint of interstate trade and commerce. The decisions of the lower federal courts in this case are reported in 106 Fed. 38 (1900); 115 Fed. 27 (1902).

An association of manufacturers

and dealers formed for the purpose of controlling the production of articles made only in a particular State, but principally used in other States, and which has reduced production and arbitrarily raised prices, directly affects interstate commerce and violates the federal statute.

*Gibbs v. McNeeley*, 118 Fed. 120 (1902), reversing 107 Fed. 210 (1901).

A contract or combination between a fuel company and an association composed of fourteen producers of coal and coke in a certain territory, by which the fuel company was to take the entire output of such producers intended for the Western market and to sell the same at not less than minimum prices fixed by the executive committee of the association and account for the proceeds—the executive committee also fixing the amount of coal to be furnished by each member—and under which shipments were made into different States, directly affects interstate commerce and is in conflict with the federal statute.

*Chesapeake, etc. Fuel Co. v. United States*, 115 Fed. 610 (1902), affirming 105 Fed. 93 (1900).

See also *Wheeler-Stenzel Co. v. National Glass Jobbers' Ass'n*, 152 Fed. 864 (1907); *Ellis v. Inman*, 131 Fed. 182 (1904); *Continental Wall Paper Co. v. Voight*, 148 Fed. 939 (1906). Compare *Phillips v. Iola Portland Cement Co.*, 125 Fed. 593 (1903).

<sup>2</sup> In *Swift v. United States*, 196 U. S. 375, 396 (1905), Mr. Justice Holmes said: "Although the combination alleged embraces restraint and monopoly of trade within a single

The distinction is between a combination which relates to manufacture, and the direct object of which is to monopolize

State, its effect upon commerce among the States is not accidental, secondary, remote or merely probable. On the allegations of the bill the latter commerce no less, perhaps even more, than commerce within a single State is an object of attack.

... Moreover, it is a direct object, it is that for the sake of which the several specific acts and courses of conduct are done and adopted. Therefore the case is not like *United States v. E. C. Knight Co.*, 156 U. S. 1 (1895), (15 Sup. Ct. Rep. 249), where the subject-matter of the combination was manufacture and the direct object monopoly of manufacture within a State. However likely monopoly of commerce among the States in the article manufactured was to follow from the agreement it was not a necessary consequence nor a primary end. Here the subject-matter is sales and the very point of the combination is to restrain and monopolize commerce among the States in respect of such sales. The two cases are near to each other, as sooner or later always must happen where lines are to be drawn, but the line between them is distinct."

In this case (*Swift v. United States*) it was held that "a combination of a dominant proportion of the dealers in fresh meat throughout the United States not to bid against each other in the live stock markets of the different States, to bid up prices for a few days in order to induce the cattlemen to send their stock to the stockyards, to fix prices at which they will sell, and to that end to restrain shipments of meat when necessary, to establish a uniform rule of conduct to dealers and to keep a black list, to make uniform and improper charges for cartage and, finally, to get less than lawful rates

from the railroads to the exclusion of competitors" was an illegal combination in restraint of interstate commerce in violation of the federal anti-trust statute.

The very recent decision of the Supreme Court in *Loewe v. Lawlor*, 208 U. S. 274 (1908), (28 Sup. Ct. Rep. 301), also distinctly supports the view that while the business of manufacturing in one State does not in itself directly affect interstate commerce, yet that a combination whose object is to prevent the manufacturer from shipping his products into other States does directly affect interstate commerce and violate the act. In this case the Court by Mr. Chief Justice Fuller said (p. 300): "The averments here are that there was an existing interstate traffic between plaintiffs and citizens of other States, and that for the direct purpose of destroying such interstate traffic defendants combined not merely to prevent plaintiffs from manufacturing articles then and there intended for transportation beyond the State, but also to prevent the vendees from reselling the hats which they had imported from Connecticut or from further negotiating with plaintiffs for the purchase and intertransportation of such hats from Connecticut to the various places of destination. So that, although some of the means whereby the interstate traffic was to be destroyed were acts within a State, and some of them were in themselves as a part of their obvious purpose and effect beyond the scope of federal authority, still, as we have seen, the acts must be considered as a whole, and the plan is open to condemnation, notwithstanding a negligible amount of intrastate business might be affected in carrying it out. If the purposes of the combination

and affect manufacture within a State — to which the *Knight* decision applies — and a combination whose direct object is to restrain and monopolize interstate commerce in respect of the sale of the manufactured product.<sup>1</sup>

A combination of manufacturers or producers which directly restrains commerce among the States is not relieved from the operation of the federal statute by the fact that it may also, in some degree, affect intrastate commerce.<sup>2</sup>

§ 394. **Restraint upon Interstate Commerce must be Direct — (C) Restraints upon Facilities for Commerce.** — As already shown, the combination condemned by the anti-trust act is one whose direct and immediate effect is a restraint upon interstate commerce. In thus applying the statute, a distinction is drawn between a combination or contract which directly affects and interferes with interstate commerce, and one which relates to a local facility provided in furtherance and aid of such commerce. These facilities may consist of privileges and conveniences provided and made use of, and services rendered, in aid of commerce, as well as in the use of tangible property. Such facilities are not, in themselves, a part of interstate commerce, and touch it only in an indirect way. Charges for such facilities are not a restraint upon interstate commerce, although the cost of conducting an interstate business may be thereby increased; and agreements or combinations relating to the amount of such charges or the furnishing of such facilities are

were, as alleged, to prevent any interstate transportation at all, the fact that the means operated at one end beyond physical transportation commenced and at the other end after the physical transportation ended was immaterial."

<sup>1</sup> But while the distinction stated in the text is undoubtedly well founded, its practical application in particular cases, *e.g.* the case of a corporate combination engaged in manufacturing, is most difficult. The later decisions of the Supreme Court of the United States to which reference has been made, indicate that the decision in the *Knight* case is of limited application. But to what

extent a combination must control disposition — what must be done in addition to manufacturing articles designed to be shipped to other States — in order to directly affect interstate commerce cannot well be determined in advance of a decision of the Supreme Court.

<sup>2</sup> *Swift v. United States*, 196 U. S. 375 (1905), (25 Sup. Ct. Rep. 276); *Loewe v. Lawlor*, 208 U. S. 274 (1908), (28 Sup. Ct. Rep. 301); *Montague v. Lowry*, 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307).

See extracts from the opinions in these cases in preceding notes to this section.

not in contravention of the federal statute, however much they may offend against public policy or local law.<sup>1</sup>

In *Hopkins v. United States*,<sup>2</sup> — a case which related to an association of commission men for the purpose, primarily, of regulating the sale of live stock upon its arrival at stockyards — the Supreme Court of the United States said: "The selling of an article at its destination, which has been sent from another State, while it may be regarded as an interstate sale and one which the importer was entitled to make, yet the services of the individual employed at the place where the article is sold are not so connected with the subject sold as to make them a portion of interstate commerce, and a combination in regard to the amount to be charged for such service is not, therefore, a combination in restraint of that trade or commerce."<sup>3</sup>

<sup>1</sup> *Hopkins v. United States*, 171 U. S. 578 (1898), (19 Sup. Ct. Rep. 40); *Anderson v. United States*, 171 U. S. 604 (1898), (19 Sup. Ct. Rep. 50).

<sup>2</sup> *Hopkins v. United States*, 171 U. S. 590 (1898), (19 Sup. Ct. Rep. 40). The following is a summary of the facts in this case: The Kansas City Live Stock Exchange was a voluntary association doing business at the stockyards in Kansas City. The business of its members was to receive, individually, consignments of live stock from owners living in different States, to feed the stock and prepare it for the market; to sell it, receive the price and remit the proceeds, after deducting commissions, advances and expenses, to the owners. The members solicited consignments and made advances thereon. The rules of the association forbade members from buying stock of merchants in Kansas City, not members of the exchange, fixed commissions, and provided that no member should do business with any person violating the rules. The stockyards were situated partly in Missouri and partly in Kansas, but this fact was deemed unimportant by all the courts.

A bill by the United States against *Hopkins*, and other members of the association, was filed, charging that the association was in violation of the Act of July 2, 1890, and praying for an injunction. The trial court granted the injunction (82 Fed. 529 (1897)), and the case came by certiorari from the Circuit Court of Appeals to the Supreme Court, which reversed the decree. See also *Green v. Stoller*, 77 Fed. 1 (1896), which related to the Kansas City Live Stock Exchange.

<sup>3</sup> In *Swift v. United States*, 196 U. S. 375, 397 (1905), (25 Sup. Ct. Rep. 276) (see note to § 393, *ante*), the Supreme Court distinguished the *Hopkins* case, saying: "All that was decided there was that the local business of commission merchants was not commerce among the States, even if what the brokers were employed to sell was an object of such commerce. The brokers were not, like the defendants before us, themselves the buyers and sellers. They only furnished certain facilities for the sales. Therefore, there again the effect of the combination of brokers upon the commerce was only indirect and not within the act."

§ 395. **Restraint upon Interstate Commerce must be Direct — (D) Exchanges and Similar Associations.** — Upon the principle stated in the preceding sections that, in order to come within the provisions of the federal statute, the direct effect of a combination must be in restraint of interstate commerce, it follows that a voluntary association or "exchange" formed by dealers in articles of a similar nature in a particular locality for the purpose of fairly regulating the methods of conducting business and establishing a general headquarters, and the by-laws of which provide rules for fair dealing among the members, but which exercises no control over prices or production, is not in contravention of the statute.<sup>1</sup> Neither the object nor

<sup>1</sup> *Anderson v. United States*, 171 U. S. 604 (1898), (19 Sup. Ct. Rep. 50); *Hopkins v. United States*, 171 U. S. 578 (1898), (19 Sup. Ct. Rep. 40).

In the *Anderson* case, the Traders' Live Stock Exchange was a voluntary association in Kansas City, whose members carried on much the same business, and in the same manner, as that carried on by members of the Kansas City Live Stock Exchange passed upon in the *Hopkins* case (*ante*, § 394, *note*). The principal difference was that the members of the Traders' Exchange were themselves purchasers of cattle in the market, while the members of the other association sold cattle upon commission. In holding that the association did not violate the anti-trust act, the Supreme Court of the United States (*per* Peckham, J.) said (p. 616): "From very early times it has been the custom for men engaged in the business of buying and selling articles of a similar nature, at any particular place, to associate themselves together. The object of the association has, in many cases, been to provide for the ready transaction of the business of the associates by obtaining a general headquarters for its conduct, and thus to insure a quick and certain market for the sale or purchase of the article dealt in. Another purpose has been to provide a

standard of business integrity among the members by adopting rules for just and fair dealing among them, and enforcing the same by penalties for their violation. The agreements have been voluntary, and the penalties have been enforced under the supervisions and by the members of the association. The preamble adopted by the association in this case shows the ostensible purpose of its formation. It was not formed for pecuniary profits, and a careful perusal of the whole agreement fails, as we think, to show that its purpose was other than as stated in the preamble, and that the result naturally to be expected from an enforcement of the rules would not directly, if at all, affect interstate trade or commerce."

The Court then distinguished the agreement in question from those in *United States v. Jellico Mountain Coal, etc. Co.*, 46 Fed. 432 (1891); *United States v. Coal Dealers Ass'n*, 85 Fed. 252 (1898); and *United States v. Addyston Pipe, etc. Co.*, 85 Fed. 271 (1898), (*affirmed* 175 U. S. 211) (1899), (20 Sup. Ct. Rep. 96), upon the ground that the agreements in all those cases provided for fixing the prices of the articles dealt in. In comparing these cases, also note *United States v. Chesapeake, etc. Fuel Co.*, 105 Fed. 93 (1900), *affirmed*

consequence of such an association is to suppress competition and its effect upon interstate commerce, if any, is remote.

§ 396. **Restraint may be imposed upon those engaged in Interstate Commerce by those not engaged therein.** — The federal statute makes unlawful “every” contract, combination or conspiracy in restraint of interstate commerce. It makes no distinction of persons or classes. Persons not themselves engaged in interstate commerce who enter into a combination to compel third persons to refrain from engaging in such commerce, except upon conditions imposed by them, violate its provisions.<sup>1</sup> Thus, a combination in the form of a labor organization which, for the purpose of enforcing compliance with its requirements, attempts to prevent a manufacturer from making articles for interstate shipment, and purchasers of such articles in other States from reselling them and making further purchases, is in contravention of the act.<sup>2</sup>

115 Fed. 610 (1902); *Gibbs v. Mc-Neeley*, 118 Fed. 120 (1902); *Lowry v. Tile, etc. Assoc.*, 106 Fed. 38 (1900), *affirmed sub nom. Montague v. Lowry*, 115 Fed. 27 (1902); 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307).

In the last case the Supreme Court distinguished the association in question from those in the *Hopkins* and *Anderson* cases, *supra*, saying: “In the first case it was held that the occupation of the members of the association was not interstate commerce and in the other that the subject of the agreement did not directly relate to, embrace or act upon, interstate commerce.”

And in *Swift v. United States*, 196 U. S. 375, 397 (1905), (25 Sup. Ct. Rep. 276) (see note to § 393, *ante*), the Supreme Court again said of the *Anderson* case: “In [it] the defendants were buyers and sellers at the stockyards, but their agreement was merely not to employ brokers, or to recognize yard traders, who were not members of their association. Any yard trader could become a member of the association on complying with the conditions, and there

was said to be no feature of monopoly in the case. It was held that the combination did not directly regulate commerce between the States, and, being formed with a different intent, was not within the act.”

<sup>1</sup> In *Loewe v. Lawlor*, 208 U. S. 274 (1908), (28 Sup. Ct. Rep. 301), the Supreme Court said: “Nor can the act be held inapplicable because defendants were not themselves engaged in interstate commerce. The act made no distinction between classes. It provided that ‘every’ contract, combination or conspiracy in restraint of trade was illegal. The records of Congress show that several effects were made to exempt, by legislation, organizations of farmers and laborers from the operation of the act, and that all these efforts failed, so that the act remained as we have it before us.” See also *United States v. Workingmen’s Amalgamated Council*, 54 Fed. 994 (1893), *affirmed* 57 Fed. 85 (1893).

<sup>2</sup> *Loewe v. Lawlor*, 208 U. S. 274 (1908), (28 Sup. Ct. Rep. 301). In this case the Supreme Court held that a complaint stated an unlawful com-

§ 397. **Form of Combination Immaterial. Illegality of Corporate Device.** — In the *Trans-Missouri Freight Association Case* it was urged that the federal statute was inapplicable to an association of railroad companies for the purpose of regulating traffic rates, because the language, "every contract, combination in the form of trust or otherwise," covers only contracts or combinations in the trust form or those which, while not exactly trusts, are of a similar form or nature. But the Supreme Court of the United States said:<sup>1</sup> "This is clearly not so. While the statute prohibits all combinations in the form of trust or otherwise, the limitation is not confined to that form alone. All combinations which are in restraint of trade or commerce are prohibited, whether in the form of trusts or in any other form whatever."

Every contract, combination or conspiracy in restraint of interstate or foreign commerce is illegal. The method adopted in bringing about the combination is immaterial; and the device of a holding corporation for the purpose of circumventing the law can be no more effectual than any other means. While a corporation, in the legitimate exercise of power conferred, may purchase and hold the shares of other corporations, the formulation of a holding corporation, *as a part of a scheme*

combination within the statute which averred in substance "that there was an existing interstate traffic between plaintiffs and citizens of other States, and that for the direct purpose of destroying such interstate traffic defendants combined not only to prevent plaintiffs from manufacturing articles then and there intended for transportation beyond the State, but also to prevent the vendees from reselling the hats which they had imported from Connecticut, or from further negotiating with plaintiffs for the purchase and intertransportation of such hats from Connecticut to the various places of destination."

<sup>1</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 326 (1897), (17 Sup. Ct. Rep. 540).

*United States v. Debs*, 64 Fed. 747

(1894): "It is, therefore, the privilege and duty of the court, uncontrolled by considerations drawn from other sources, to find the meaning of the statute in the terms of its provisions, interpreted by the settled rules of construction. That the original design to suppress trusts and monopolies created by contract or combination in the form of trust, which of course would be of a 'contractual character,' was adhered to, is clear; but it is equally clear that a further and more comprehensive purpose came to be entertained, and was embodied in the final form of the enactment. Combinations are condemned, not only when they take the form of trusts, but in whatever form found, if they be in restraint of trade. That is the effect of the words 'or otherwise.'"



to bring about a combination of competing railroad companies — a practical consolidation through the pooling of earnings and virtual pooling of stocks — in restraint of interstate or foreign commerce, seems clearly in violation of the provisions of the statute.<sup>1</sup>

§ 397a. **The Northern Securities Case.** — The opinion expressed in the preceding section that a combination of competing railroads by means of a holding corporation contravenes the federal statute has, since the first edition of this treatise, been fully sustained by the Supreme Court of the United States in one of the most important cases ever brought before that tribunal.

The Great Northern and Northern Pacific railroad companies own competing and practically parallel roads engaged in interstate commerce and extending from the Great Lakes and Mississippi River to the Pacific coast. Stockholders of these corporations combined, and conceived the scheme of organizing a New Jersey corporation which should acquire the shares of the two corporations — issuing its own shares to their stockholders in exchange therefor upon an agreed basis — and thus obtain control of both corporations. To carry out this plan, the Northern Securities Company was organized, with the necessary powers, as the holding corporation. The stockholders of the two constituent corporations then exchanged

<sup>1</sup> A corporate combination by means of a purchasing corporation (see *ante*, §§ 310, 318), when producing similar results, is as much subject to the provisions of the federal anti-trust statute as a corporate combination by means of a holding corporation (see *ante*, §§ 310, 323). There is no merit in the corporate form of combination in imposing restraints upon interstate commerce. That which contravenes the statute when done by individuals collectively violates it when effected by them through the instrumentality of a corporation.

For distinction between *actual* purchases and sales and combinations in the *form* of sales, see *ante*, § 354:

*"Analysis of Rules governing Private Corporations. Form of Combination Immaterial."*

The provisions of the federal statute against the *monopolizing* of interstate trade or commerce necessarily relate to different acts than the provisions against combinations. A single corporation actually purchasing all the plants engaged in the production of an article of commerce undoubtedly might monopolize trade and commerce in such article in contravention of the statute without there being any element whatever of combination present. But this phase of the subject has as yet received slight judicial consideration.

their shares upon the agreed basis for those of the holding corporation, which thus obtained controlling interests in both corporations. The result was a corporate combination by means of a holding corporation which we have already considered.<sup>1</sup> A suit was brought by the United States under the federal anti-trust statute to have the combination declared illegal. The case came to the Supreme Court, which held that the arrangement was a combination in restraint of interstate commerce in violation of the federal statute and, in effect, enjoined its continuance.<sup>2</sup>

Mr. Justice Harlan,<sup>3</sup> in his opinion, stated these propositions as deducible from former decisions upon the statute and, consequently, as controlling the disposition of the case:

“That although the act of Congress known as the Anti-trust Act has no reference to the mere manufacture or production of articles or commodities within the limits of the several States, it does embrace and declare to be illegal every contract, combination or conspiracy, in whatever form, of whatever nature, and whoever may be parties to it, which directly or necessarily operates *in restraint of trade or commerce among the several States or with foreign nations*;

<sup>1</sup> See *ante*, § 310: “*Formation of Corporate Combinations.*”

<sup>2</sup> Northern Securities Co. v. United States, 193 U. S. 197 (1904), (24 Sup. Ct. Rep. 436).

After the decree of the Supreme Court declaring the Northern Securities Company a combination in violation of the federal anti-trust statute it adopted a resolution reducing its corporate stock and providing for the distribution of its assets—shares in the Great Northern and Northern Pacific railroad companies—*pro rata* among its stockholders. A suit was brought to restrain such distribution upon the ground that the complainants had delivered their Northern Pacific stock to the Securities Company in trust and were entitled to have such stock returned to them. When the case came before

the Supreme Court, however, it held that the Securities Company was the owner of the shares in question free from any trust and might properly distribute them among its stockholders as proposed.

Harriman v. Northern Securities Co., 197 U. S. 244 (1905), (25 Sup. Ct. Rep. 493).

For other phases of the litigation regarding the Northern Securities Company see *ante*, § 36: “*Construction of Prohibitions—(D) Control of Competing Railroads by Holding Corporation.*”

<sup>3</sup> The opinion of Mr. Justice Harlan was concurred in by Brown, McKenna and Day, J.J. Mr. Justice Brewer concurred in the result but wrote a separate opinion. The other justices dissented.

That the act is not limited to restraints of interstate and international trade or commerce that are unreasonable in their nature, but embraces *all* direct *restraints* imposed by any combination, conspiracy or monopoly upon such trade or commerce;

That railroad carriers engaged in interstate or international trade or commerce are embraced by the act;

That combinations even among *private* manufacturers or dealers whereby *interstate or international commerce* is restrained are equally embraced by the act;

That Congress has the power to establish *rules* by which *interstate and international commerce* shall be governed, and, by the Anti-trust Act, has prescribed the rule of free competition among those engaged in such commerce;

That *every* combination or conspiracy which would extinguish competition between otherwise competing railroads engaged in *interstate trade or commerce*, and which would *in that way* restrain such trade or commerce, is made illegal by the act;

That the natural effect of competition is to increase commerce, and an agreement whose direct effect is to prevent this play of competition restrains instead of promotes trade and commerce;

That to vitiate a combination, such as the act of Congress condemned, it need not be shown that the combination in fact results or will result in a total suppression of trade or in a complete monopoly, but it is only essential to show that by its necessary operation it tends to restrain interstate or international trade or commerce or to deprive the public of the advantages that flow from free competition;

That the constitutional guaranty of liberty or contract does not prevent Congress from prescribing the rule of free competition for those engaged in *interstate and international commerce*; and,

That under its power to regulate commerce among the several States and with foreign nations, Congress had authority to enact the statute in question."

Mr. Justice Harlan further said in declaring the particular combination in conflict with the federal statute:

"Such holding corporation has become the holder — more

properly speaking, the custodian — of more than nine-tenths of the stock of the Northern Pacific, and more than three-fourths of the stock of the Great Northern, the stockholders of the companies who delivered their stock receiving upon the agreed basis shares of stock in the holding corporation. The stockholders of these two competing companies disappeared, as such, for the moment, but immediately reappeared as stockholders of the holding company which was thereafter to guard the interests of both sets of stockholders as a unit, and to manage, or cause to be managed, both lines of railroad as if held *in one ownership*. Necessarily by this combination or arrangement the holding company in the fullest sense dominates the situation in the interest of those who were stockholders of the constituent companies; as much so, for every practical purpose, as if it had been itself a railroad corporation which had built, owned, and operated both lines for the exclusive benefit of its stockholders. Necessarily, also, the constituent companies ceased, under such a combination, to be in active competition for trade and commerce along their respective lines, and have become, practically, one powerful consolidated corporation, by the name of a holding corporation the principal, if not the sole, object for the formation of which was to carry out the purpose of the original combination under which competition between the constituent companies would cease. . . . No scheme or device could more certainly come within the words of the act — ‘combination in the form of a trust or otherwise . . . in restraint of commerce among the several States or with foreign nations,’ — or could more effectively and certainly suppress free competition between the constituent companies. This combination is, within the meaning of the act, a ‘trust’; but if not it is a *combination in restraint of interstate and international commerce*; and that is enough to bring it under the condemnation of the act.”

**§ 398. Application of Statute to Combinations of Railroads and Other Carriers. Combinations of Railroad Employees.** — The statute declares illegal *every* contract, combination or conspiracy in restraint of commerce among the several States. Railroad companies and other carriers engaged in transporting persons and property between different States are engaged in

interstate commerce,<sup>1</sup> and, as indicated in the last two sections, any contract or combination between competing carriers for the purpose of maintaining rates or preventing competition, directly restrains interstate commerce and contravenes the federal statute.<sup>2</sup>

<sup>1</sup> *United States v. Joint Traffic Ass'n*, 171 U. S. 570 (1898), (20 Sup. Ct. Rep. 96): "The business of a railroad carrier is of a public nature, and in performing it the carrier is also performing, to a certain extent, a function of government which, as counsel observed, requires them to perform the service on equal terms to all. This public service, that of transportation of passengers and freight, is a part of trade and commerce, and when transported between States, such commerce becomes what is described as interstate, and comes, to a certain extent, under the jurisdiction of Congress, by virtue of its power to regulate commerce among the several States."

<sup>2</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 290 (1897), (17 Sup. Ct. Rep. 540); *United States v. Joint Traffic Ass'n*, 171 U. S. 505 (1898), (19 Sup. Ct. Rep. 25). The nature of an agreement between carriers which falls within the provisions of the federal anti-trust act, cannot be better illustrated than by outlining the traffic arrangements involved in these two leading cases.

In the *Trans-Missouri Case* it appeared that eighteen competing Western railroad companies formed, in 1889, a voluntary association called the "Trans-Missouri Freight Association," for the purpose, as stated in the agreement, "of mutual protection by establishing and maintaining reasonable rates, rules and regulations, on all freight traffic, both through and local." The agreement provided for electing a chairman of the association, and representatives of each company to vote in its behalf

at the monthly meetings of the association; for appointing a committee to establish traffic rates and regulations, "and to make rules for meeting the competition of outside lines;" for changing rates; for arranging with connecting lines when authorized by the association, and for imposing and enforcing the penalties prescribed for infractions of the agreement.

Bill by the United States for dissolution of the association, and for an injunction, on the ground that the agreement violated the federal anti-trust act was dismissed by the Circuit Court (53 Fed. 440 (1892)). This decree was affirmed by the Circuit Court of Appeals (58 Fed. 58 (1893)), but was reversed by the Supreme Court.

In the *Joint Traffic Association Case* it appeared that thirty-one railroad companies engaged in transportation between Chicago and the Atlantic Coast, formed a voluntary association called the Joint Traffic Association, by which they agreed that the association should have jurisdiction over all competitive traffic, with certain exceptions, passing through the western termini of the trunk lines and certain other points, and to fix the rates, fares and charges therefor, and to change the same, and no party to the agreement was permitted to deviate from the rates so fixed. The agreement also provided for the appointment of managers of the association; that the powers conferred upon the managers should be exercised in conformity to the provisions of the interstate commerce act, and that the managers should have power to deal with connecting companies, not parties to the

In *United States v. Trans-Missouri Freight Association*,<sup>1</sup> the Supreme Court of the United States said: "Congress has, so far as its jurisdiction extends, prohibited all contracts or combinations in the form of trust or otherwise entered into the purpose of restraining trade and commerce. The results naturally flowing from a contract or combination in restraint of trade or commerce, when entered into by a manufacturing or trading company, such as above stated, while differing somewhat from those which may follow a contract to keep up transportation rates by railroads, are nevertheless of the same nature and kind, and the contracts, themselves, do not so far differ in their nature that they may not all be treated alike and be condemned in common. It is entirely appropriate, generally, to subject corporations or persons engaged in trading or manufacturing to different rules from those applicable to railroads in their transportation business; but when the evil to be remedied is similar in both kinds of corporations, such as contracts which are unquestionably in restraint of trade, we see no reason why similar rules should not be promulgated in regard to both, and both be covered in the same statute by general language sufficiently broad to include them both. We see nothing either in contemporaneous history, in the legal situation at the time of the passage of the statute, in its legislative history, or in any general difference in the nature or kind of these trading or manufacturing companies, which would lead us to the conclusion that it cannot be supposed the legislature, in prohibiting the making of contracts in restraint of trade, intended to include railroads within the purview of that act. . . . If the law prohibits any contract or combination in restraint of trade or commerce, a contract or combination made in violation of such law is void, whatever

agreement, which declined to observe the established rates. Bill by the United States was dismissed by the Circuit Court (76 Fed. 895); the decree was affirmed by the Circuit Court of Appeals, without opinion (89 Fed. 1020), but was reversed by the Supreme Court.

See also *ante*, § 397a: "*The Northern*

*Securities Case*," in which case Mr. Justice Harlan said as already shown: "Railroad carriers engaged in interstate or international trade or commerce are embraced by the act."

<sup>1</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 324 (1897), (17 Sup. Ct. Rep. 540).

may have been theretofore decided by the courts to have been the public policy of the country on that subject. The conclusion which we have drawn from the examination above made into the question before us is that the anti-trust act applies to railroads, and that it renders illegal all agreements which are in restraint of trade or commerce as we have above defined that expression."<sup>1</sup>

While traffic associations and other combinations between competing carriers for the purpose of maintaining rates, or otherwise controlling or regulating competition, are in violation of the federal statute,<sup>2</sup> it has been held that an agreement between connecting railroad companies for the reception and forwarding of freight beyond their own lines, does not fall

<sup>1</sup> The conclusion that the statute applies to combinations of railroads unavoidably follows from the premise that *all* combinations in restraint of interstate commerce violate its provisions. In reaching this conclusion, however, the Supreme Court in the *Trans-Missouri Freight Association Case*, *supra*, was met by two contentions:

*First.* "That the debates in Congress show beyond a doubt that the act as passed does not include railroads." But after reviewing the debates referred to, Mr. Justice Peckham said: "All that can be determined from the debates and reports is, that various members had various views, and we are left to determine the meaning of this act, as we determine the meaning of other acts, from the language used therein."

*Second.* That the statute did not apply to traffic contracts between railroad companies, because they were authorized by the interstate commerce act, and that a construction should not be adopted which would repeal, by implication, any provision of that act. Mr. Justice Peckham, however, said: "The first answer to this argument is that, in our opinion, the commerce act does not authorize an agreement of this nature. It may

not in terms prohibit, but it is far from conferring, either directly or by implication, any authority to make it. If the agreement be legal, it does not owe its validity to any provision of the commerce act, and if illegal, it is not made so by that act. The fifth section prohibits what is termed 'pooling,' but there is no express provision in the act prohibiting the maintenance of traffic rates among competing roads by making such an agreement as this, nor is there any provision which permits it. . . . As the commerce act does not authorize this agreement, argument against a repeal by implication of the provisions of the act which, it is alleged, grant such authority becomes ineffective. There is no repeal in the case and both statutes may stand, as neither is inconsistent with the other."

<sup>2</sup> A pooling contract between carriers by water operating between points in different States is in violation of the federal anti-trust statute and it is immaterial that it might be valid with respect to traffic between points in one of the States.

*White Star Line v. Star Line*, 141 Mich. 604 (1905), (105 N. W. Rep. 135, 113 Am. St. Rep. 551).

within the provision of the statute;<sup>1</sup> nor is this result altered by the fact that special facilities, in the way of advancement of freight charges, may be granted.<sup>2</sup> Upon similar principles, it was held that a custom or usage existing among several express companies for mutual advantage, for a receiving company to pay accrued charges on goods, or transport them to their destination without prepayment of charges, was not prohibited by the statute.<sup>3</sup>

In determining whether a particular combination of carriers comes within the provisions of the statute, the intent of the parties and the degree of the restraint are unimportant.<sup>4</sup> The essential question is *whether the contract or combination in design or effect restrains trade and commerce in any way and to any extent.*<sup>5</sup>

<sup>1</sup> Prescott, etc. R. Co. v. Atchison, etc. R. Co., 73 Fed. 438 (1896). The conclusion of the Court in this case, that the agreement in question did not contravene the provisions of the federal anti-trust act, is probably well founded, but the reasons stated for so holding, that that act "is directed solely against contracts which would have been unlawful before the passage of the act," is directly opposed to the ruling of the Supreme Court in the *Trans-Missouri* case (*ante*, § 387), which was announced after the decision in this case. The true reason for holding the agreement not in contravention of the statute would seem to be that it was not in restraint of trade or commerce.

<sup>2</sup> Gulf, etc. R. Co. v. Miami Steamship Co., 86 Fed. 407 (1898).

A contract between a railroad company and an individual for the purpose of developing the business of transporting milk upon the former's road whereby the latter was granted full charge of such business and the exclusive privilege of transporting milk so far as permitted by law, upon a commission basis, provided that he should not charge rates above

those charged by competitive roads, was held not to violate the federal anti-trust statute.

Delaware, etc. R. Co. v. Kutter, 147 Fed. 51 (1906).

<sup>3</sup> Southern Indiana Exp. Co. v. United States Exp. Co., 88 Fed. 659 (1898), *affirmed* 92 Fed. 1022 (1899).

<sup>4</sup> United States v. Trans-Missouri Freight Ass'n, 166 U. S. 341 (1897), (17 Sup. Ct. Rep. 540).

<sup>5</sup> *Desirability of exempting railroad traffic contracts from operation of federal anti-trust statute.*

Whatever may be said regarding the desirability of an amendment to the federal statute making it applicable only to contracts and combinations in *unreasonable* restraint of trade (see *ante*, § 388) the propriety of one amendment of more limited scope seems unquestionable.

As we have seen, the decisions in the *Trans-Missouri* and *Joint Traffic Association* cases, although necessarily following from the broad language of the statute, confine the right of railroad companies to coöperate within very narrow limits. They have no right to enter into agreements in any form to maintain rates. And yet some measure of coöperation



The federal anti-trust statute applies not only to combinations of railroad companies and other carrier corporations engaged in interstate commerce but to the agreements and combinations of the *employees* of such corporations when their object or effect is the obstruction of such commerce.<sup>1</sup>

§ 399. **Application of Statute to Combinations under Patents.** — The object of patent laws being monopoly, conditions imposed by a patentee in licenses granted under his patent, with respect to the use of the patented article when manufactured, the price to be charged therefor and any other conditions not in themselves unlawful, are not in contravention of the federal anti-trust statute. The license may run exclusively to the licensee, who may in turn stipulate to manufacture only under the patent, and other provisions may be inserted for the express purpose of keeping up the monopoly. Still the

with respect to rates is necessary. If each railroad company should make its own classification and fix its rates without regard to the charges of its competitors, rebates and other discriminations would become the rule. The railroad which happened to make the lowest rate would get all the traffic. Business could hardly be carried on under such conditions. The result is that while formal traffic contracts have been eliminated since these decisions, informal understandings — “gentlemen’s agreements” — have taken their place.

But this is not a proper basis for railroad business to be conducted upon. Informal understandings are shifting and uncertain. They are lived up to in prosperous times when there is less need for them. But in times of depression when they are needed and when there is not enough business to go around they can be and are readily evaded. And, moreover, railroad companies should not be driven to subterfuges.

Whether, therefore, it be desirable to legalize pooling (see *ante*, § 364a, *Associations of Railroads — (C) Pools*),

it is believed that the federal anti-trust statute should be modified in its effect upon railroad agreements. A statute providing that traffic agreements, when approved by the Interstate Commerce Commission, should be lawful and enforceable, would be both conservative and effective.

<sup>1</sup> A combination of railroad employees to prevent railroad companies engaged in interstate commerce from operating their roads until certain demands upon them are complied with is a conspiracy in restraint of trade and commerce in violation of the federal statute. *United States v. Elliott*, 64 Fed. 27 (1894), s. c. 62 Fed. 801 (1894). See also *Thomas v. Cincinnati, etc. R. Co.*, 62 Fed. 803 (1894). Compare *United States v. Patterson*, 55 Fed. 605 (1893). And see also *United States v. Workmen’s Amalg. Council*, 54 Fed. 994 (1893); *In re Debs*, 64 Fed. 724 (1894); 158 U. S. 564 (1895), (15 Sup. Ct. Rep. 900).

For consideration of application of statute to rules of an association of railroad employees, see *Waterhouse v. Comer*, 55 Fed. 150 (1893).

agreement is neither unlawful at common law nor under the federal act because the monopoly is not created by it but by the grant of the patent.<sup>1</sup>

In *Bement v. National Harrow Company*<sup>2</sup> the Supreme Court of the United States said: "The general rule is absolute freedom in the use or sale of rights under the patent laws of the United States. The very object of these laws is monopoly, and the rule is, with few exceptions, that any conditions which are not in their very nature illegal with regard to this kind of property, imposed by the patentee and agreed to by the licensee for the right to manufacture or use or sell the article, will be upheld by the courts. The fact that the conditions in the contracts keep up the monopoly or fix prices does not render them illegal. . . . It is true that it has been held by this court that the [federal anti-trust] act includes any restraint of commerce, whether reasonable or unreasonable. . . . But that statute clearly does not refer to that kind of a restraint of interstate commerce which may arise from reasonable and legal conditions imposed upon the assignee or licensee of a patent by the owner thereof, restricting the terms upon which the article may be used and the price to be demanded therefor."

Upon similar principles different licensees under the *same*

<sup>1</sup> *Bement v. National Harrow Co.*, 186 U. S. 70 (1902), (22 Sup. Ct. Rep. 747); *Indiana Mfg. Co. v. J. I. Case Threshing Mach. Co.*, 154 Fed. 365 (1907); *Rubber Tire Wheel Co. v. Milwaukee Rubber Works Co.*, 154 Fed. 358 (1907); *U. S. Consolidated Seeded Raisin Co. v. Griffin*, 126 Fed. 364 (1903); *Victor Talking Mach. Co. v. The Fair*, 123 Fed. 424 (1903).

<sup>2</sup> *Bement v. National Harrow Co.*, 196 U. S. 91 (1902), (22 Sup. Ct. Rep. 747).

The National Harrow Company was a corporation to which about twenty manufacturers of spring tooth harrows assigned the patents owned by them — eighty-five in number — receiving in return stock in the corporation and a license to manufacture

the harrow previously made — the corporation fixing the price. This corporation had been repeatedly held to be an unlawful combination before the decision by the Supreme Court in the *Bement* case, *supra*. See *National Harrow Co. v. Hench*, 76 Fed. 669 (1896), *affirmed* 83 Fed. 36 (1897); *National Harrow Co. v. Quick*, 67 Fed. 130 (1895). And see *Strait v. National Harrow*, 18 N. Y. Supp. 224 (1891). Compare *Strait v. National Harrow Co.*, 51 Fed. 819 (1892).

It must be observed that only one phase of the legal questions involved in determining whether the National Harrow Company was an unlawful combination was presented to the Supreme Court in the *Bement* case, viz.: that of the license contract.

patent may combine for the regulation of prices and production.<sup>1</sup> Unless such a combination amounts to a conspiracy the injury to the public resulting therefrom arises rather from the exclusive nature of the patent than from the combination under it. So, undoubtedly, where a corporation or individual acquires in a single ownership *different* patents and grants licenses for their use — even to different manufacturers — containing conditions with respect to the manufacture and sale of the article covered by them the result, although in a sense a combination, is not unlawful if confined to the preservation of the monopoly in the specific patent privileges.<sup>2</sup> Indeed, it has been held that such license contracts would not conflict with the federal statute if all the manufacturers of the article in the country obtained them.<sup>3</sup>

And, carrying the doctrine further and to the not illogical extent that patented articles are really not articles of commerce at all — that the public have no right to require that competition in them should be kept open — the weight of authority supports the view that combinations of *different* owners of *different* patents with respect to the production and prices of the article covered by them are not in violation of the federal statute.<sup>4</sup> But if this broad view be correct it must be subject

It did not appear that other manufacturers had entered into similar contracts, and the Supreme Court expressly refrained from expressing an opinion based upon the theory that they had done so.

<sup>1</sup> The cases cited in the first note to this section necessarily establish this proposition.

<sup>2</sup> *Indiana Mfg. Co. v. J. I. Case Threshing Mach. Co.*, 148 Fed. 28 (1906). The decision in this case, although reversed upon appeal (154 Fed. 365 (1907)), as not going far enough, is entitled to much consideration. See also *National Harrow Co. v. Hench*, 76 Fed. 667 (1896), *affirmed* 83 Fed. 36 (1897); *Rubber Wheel Co. v. Milwaukee Rubber Works Co.*, 142 Fed. 531 (1906), *reversed* 154 Fed. 358 (1907).

<sup>3</sup> *Indiana Mfg. Co. v. J. I. Case Threshing Mach. Co.*, 154 Fed. 365 (1907).

<sup>4</sup> In *Rubber Tire Wheel Co. v. Milwaukee Rubber Work*, 154 Fed. 358 (1907) the Circuit Court of Appeals for the Seventh Circuit said (p. 362): "Under its constitutional right to regulate interstate commerce Congress made illegal 'every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several States,' and subjected to liability to fine or imprisonment 'every person who shall monopolize, or attempt to monopolize, or combine, or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states.' Congress, having created

to the limitation that the right to combine with respect to the sale of an article covered by patents can never be extended to justify a combination to control the sale of an article not covered by such patents.

**§ 400. Application of Statute to Combinations under Copyrights.** — The broad principle indicated in the last section that agreements for the purpose of keeping up a lawful monopoly are not within the federal statute is as applicable to contracts in respect of copyrights as to contracts in respect of patents. The anti-trust act in no way curtails the privileges granted by the copyright or patent laws.

Agreements, therefore, between a publisher owning or controlling copyrights and retailers, with respect to the prices at which the books protected by such copyrights shall be sold, are valid and enforceable. But in the absence of such an agreement, and based upon the copyright statute alone, a publisher

the patent law, had the right to repeal or modify it, in whole or in part, directly or by necessary implication. The Sherman law contains no reference to the patent law. Each was passed under a separate and distinct constitutional grant of power; each was passed professedly to advantage the public; the necessary implication is not that one iota was taken away from the patent law; the necessary implication is that patented articles, unless or until they are released by the owner of the patent from the dominion of his monopoly, are not articles of trade or commerce among the several States. The evils to be remedied by the Sherman law are well understood. Articles in which the people are entitled to freedom of trade were being taken as the subjects of monopoly; instrumentalities of commerce between which the people are entitled to free competition were being combined. The means of effecting and the form of the combination are immaterial; the result is the criterion. The true test of violation of the Sherman law is

whether the people are injured, whether they are deprived of something to which they have a right."

And in *Indiana Mfg. Co. v. J. I. Case Threshing Mach. Co.*, 154 Fed. 365, 371 (1907), the same Court said: "The contracts and the business of the licensees are separate. But if as a condition to enjoying the inventions, the appellant had required the licensees to form a pool or combination for controlling the price and output of the patented article, the public would not have been injured, and consequently the Sherman law would not have been violated."

See also *U. S. Consolidated Seeded Raisin Co. v. Griffin*, 126 Fed. 364 (1903); *Central Shade Roller Co. v. Cushman*, 143 Mass. 353 (1887), (9 N. E. Rep. 629). *Contra National Harrow Co. v. Hench*, 76 Fed. 667 (1896), *affirmed* 83 Fed. 38 (1897); *National Harrow Co. v. Quick*, 67 Fed. 130 (1895); *Vulcan Powder Co. v. Hercules Powder Co.*, 96 Cal. 510 (1892), (31 Pac. Rep. 581, 31 Am. St. Rep. 342).

cannot by notice in a copyrighted book attach limitations upon the price at which it may be resold.<sup>1</sup>

Upon the theory of the recent cases relating to combinations under patents that the anti-trust statute applies only to contracts concerning articles in which the public are entitled to freedom of trade, it follows that agreements between different publishers of copyrighted books and retailers, with respect to the prices to be charged for such books, are not in violation of the federal statute. But it has been held that an agreement between publishers which goes further, and in which the members agree not to sell to dealers who cut prices in copyrighted books, and to keep a black-list of offending dealers who are not to be permitted to purchase any books of any member, is a combination in restraint of trade contrary to the act.<sup>2</sup> Certainly such a combination would be unlawful if its purpose or effect were to impose any restraints upon the purchase and sale of books not protected by copyright.

§ 401. **Application of Statute to Combinations under Secret Processes.** — The right of property in a trade secret is a monopoly not dissimilar to that under a patent or copyright and contracts by manufacturers of articles made under secret processes with dealers in respect of the conditions of resale are, upon the principles examined in the last two sections, valid and outside the scope of the federal anti-trust statute.<sup>3</sup> It

<sup>1</sup> In the very recent case of *Bobbs-Merrill Co. v. Straus*, decided by the Supreme Court, June 1, 1908, it was held that a notice printed in a copyrighted book stating the retail price at which it must be sold did not impose a limitation upon the price at which the book should be sold at retail by future purchasers with whom there was no privity of contract.

See also *Scribner v. Straus*, decided by the Supreme Court at the same time.

<sup>2</sup> *Mines v. Scribner*, 147 Fed. 927 (1906).

In *Bobbs-Merrill Co. v. Straus*, 139 Fed. 191 (1905), a similar conclusion was reached by Judge Ray.

The decision in this case was, however, affirmed by the Circuit Court of Appeals (147 Fed. 15 (1906)) and by the Supreme Court (June 1, 1908) upon the grounds stated in the preceding note.

See also *Straus v. American Publishers Ass'n*, 177 N. Y. 473 (1904), (69 N. E. Rep. 1107, 101 Am. St. Rep. 819, 64 L. R. A. 701), where it was held that the association in question in all these cases had the effect of restricting the sale of uncopyrighted books and was illegal under the New York anti-trust statute.

See *post*, Ch. XLII: "*Construction and Application of State Anti-trust Statutes.*"

<sup>3</sup> In *Dr. Miles Medical Co. v. Jaynes*

seems also to follow from the analogous decisions with respect to agreements between the owners of different patents that contracts between the proprietors of articles made under different secret processes, *e.g.* proprietary medicines, with respect to prices to be charged therefor, would not contravene the federal statute. If the public have no right to free competition in the sale of such articles it is not injured by the elimination of competition. Thus the New York Court of Appeals has held that an agreement between the manufacturers of proprietary medicines and an association of wholesale dealers in such articles to sell their goods at a uniform jobbing price for fixed quantities only to such dealers as should conform to the manufacturers' prices did not establish a monopoly at common law — all wholesale dealers having the right to purchase from the manufacturers on the same terms as members upon agreeing to maintain prices.<sup>1</sup> But a different conclusion with respect to such an agreement was reached by the Circuit Court of Appeals for the Third Circuit and it was held to violate the federal statute.<sup>2</sup>

*Drug Co.*, 149 Fed. 841 (1906), Judge Colt said: "The bill alleges that the complainant is the exclusive owner of these secret formulas, and the exclusive manufacturer of these remedies. It follows that, until voluntary disclosure or lawful discovery, the complainant has an exclusive property in these trade secrets, and has the exclusive right to make, use, and vend the article made thereunder. The exclusive right of property in a trade secret is, of necessity, a monopoly, the same as a patent or a copyright. The complainant may make these articles, or refrain from making them. It may sell them, or refrain from selling them. It may sell them to one person, and not to another, and at such prices and upon such conditions as it may deem most advantageous. Contracts like those set out in the bill concerning articles made under trade secrets, the same as similar contracts concerning articles made under a patent or a copyright, are outside the rule of restraint of

trade, whether at common law or under the federal statute."

See also *Fowle v. Park*, 131 U. S. 88 (1889); *Dr. Miles Medical Co. v. Platt*, 142 Fed. 606 (1906); *Wells and Richardson Co. v. Abraham*, 146 Fed. 190 (1906); *Dr. Miles Medical Co. v. Goldthwaite*, 133 Fed. 794 (1904).

In *Garst v. Harris*, 177 Mass. 74 (1900), (58 N. E. Rep. 174), the Supreme Judicial Court of Massachusetts clearly states the reason for the rule: "When, as here, there is a secret composition, which the defendant presumably would have no chance to sell at a profit at all but for the plaintiff's permission, a limit to the license, in the form of a restriction of the price at which he may sell, is proper enough."

<sup>1</sup> *John D. Park & Sons Co. v. National Wholesale Druggists Ass'n*, 175 N. Y. 1 (1903), (67 N. E. Rep. 136). See also *Hartmann v. John D. Park & Sons Co.*, 145 Fed. 358 (1906).

<sup>2</sup> *Jayne v. Loder*, 149 Fed. 21

In view of the conflicting decisions — especially in view of the differing decisions upon the analogous subject of combinations under patents — the right of the owners of different patents, copyrights, and secret processes to combine cannot be considered as settled in advance of a decision of the Supreme Court of the United States.

§ 402. **Application of Statute to Contracts concerning Market Quotations.** — A collection of market quotations stands like a trade secret. Consequently, upon the principles stated in the last three sections, it follows that contracts under which an exchange confidentially furnishes its quotations to telegraph companies upon condition that they shall be distributed only to persons approved by it are not contrary to the federal statute. As said by Mr. Justice Holmes in *Board of Trade v. Christie Grain, etc. Co.*:<sup>1</sup> “So far as these contracts limit the communication of what the plaintiff might have refrained from communicating to any one, there is no monopoly or attempt at monopoly, and no contract in restraint of trade, either under the statute or at common law.”

§ 403. **Application of Statute to State's Monopoly and State Regulations.** — The statute declares that every person monopolizing interstate trade or commerce shall be deemed guilty of a misdemeanor, and that the word “person” shall include “corporation” and “association.” A State, however, is neither a person, corporation or association, and the federal statute is inapplicable to a monopoly maintained by a State.<sup>2</sup>

State pilotage regulations are not in contravention of the statute because they create a monopoly in favor of the pilots licensed under them. “No monopoly or combination in a legal sense can arise from the fact that the duly authorized agents

(1906). The Court held in this case that a manufacturer of proprietary medicines may sell or withhold from selling as he pleases, and may attach such conditions to the sale of his goods as he deems proper, but that where two or more combine and agree that they will not sell to any one who cuts the prices of the others a combination in violation of the federal statute is created.

<sup>1</sup> *Board of Trade v. Christie Grain, etc. Co.*, 198 U. S. 236, 252 (1905), (25 Sup. Ct. Rep. 637).

<sup>2</sup> *Lowenstein v. Evans*, 69 Fed. 908 (1895), holding that the federal anti-trust act was inapplicable to the State of South Carolina, which, by its laws, assumed a complete monopoly of the traffic in intoxicating liquors.

of the State are alone allowed to perform the duties devolving upon them by law.”<sup>1</sup>

§ 404. **Statute not Retroactive but applies to Continuing Combinations.** — While the federal statute is not retroactive,<sup>2</sup> it applies to combinations continued in force after its enactment.<sup>3</sup> Although a combination may have been lawful when formed, its continuation after it has been declared illegal becomes a violation of the act. The statute is not of an *ex post facto* nature, but the legal effect of its enactment was to prohibit the continuance of existing combinations in contravention of its provisions, and the formation of such combinations in the future.

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## CHAPTER XL

### RIGHTS, REMEDIES AND PROCEDURE UNDER FEDERAL STATUTE

- § 405. Invalidity under Federal Statute as a Ground of Collateral Attack.
- § 406. Proceedings in Equity by Government. Injunctive Relief. Parties.
- § 407. Criminal Proceedings. Indictments. Parties.
- § 408. Actions by Government to enforce Forfeiture.
- § 409. Actions for Treble Damages. Pleadings.
- § 410. Limitations of Actions.
- § 411. Effect of Voluntary Dissolution of Combination pending Proceedings.
- § 412. Proof of Violation of Statute. Evidence.
- § 413. Interpretation of Immunity Proviso.

§ 405. **Invalidity under Federal Statute as a Ground of Collateral Attack.** — Upon principles elsewhere stated in reference to illegal combinations in general,<sup>4</sup> the fact that one of the parties to an agreement may be a combination in violation of the federal statute cannot be invoked collaterally

<sup>1</sup> *Olsen v. Smith*, 195 U. S. 332, 345 (1904), (25 Sup. Ct. Rep. 52).

<sup>2</sup> *In re Greene*, 52 Fed. 112 (1892).

<sup>3</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 342 (1897), (17 Sup. Ct. Rep. 540).

<sup>4</sup> See *ante*, § 369: “*Collateral Attack upon Combination. Remedies*

*upon Independent Contracts.*” Reference should be had to this section for consideration of the general principles applicable as well to combinations in violation of the federal statute as to those inimical to public policy.



to affect, in any manner, its independent contractual obligations or rights.<sup>1</sup> Parties dealing with the combination cannot set up its illegality as a defence to demands not connected with the illegal transaction and not dependent upon it for enforcement.

Conversely, when the combination must establish its claim through the illegal transaction, it will fail. Clean hands are essential in a court of equity, and a combination in violation of the anti-trust law cannot invoke the aid of a court of equity

<sup>1</sup> In *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 550 (1902), (22 Sup. Ct. Rep. 431), the Supreme Court of the United States said: "If the contract between plaintiff corporation and the other named corporations, persons and companies, or the combination thereby formed, was illegal under the act of Congress, then all those, whether persons, corporations or associations, directly connected therewith, became subject to the penalties prescribed by Congress. But the act does not declare illegal or void any sale made by such combination, or by its agents, of property it acquired or which came into its possession for the purpose of being sold, such property not being, at the time, in the course of transportation from one State to another or to a foreign country. The buyer could not refuse to comply with his contract of purchase upon the ground that the seller was an illegal combination which might be restrained or suppressed in the mode prescribed by the act of Congress; for Congress did not declare that a combination illegally formed under the act of 1890 should not, in the conduct of its business, become the owner of property which it might sell to who soever wished to buy it. So that there is no necessary legal connection here between the sale of pipe to the defendants by the plaintiff corporation and the alleged arrangement made by it with other corporations, companies and firms. The

contracts under which the pipe in question was sold were, as already said, collateral to the arrangement for the combination referred to, and this is not an action to enforce the terms of such arrangement. That combination may have been illegal, and yet the sale to the defendants was valid."

The federal anti-trust statute does not prevent a recovery for the breach of a collateral contract for the sale of goods although entered into by a member of a combination formed in violation of its provisions.

\* *Hadley Dean Plate Glass Co. v. Highland Glass Co.*, 143 Fed. 242 (1906); see also *Harrison v. Glucose Sugar Ref. Co.*, 116 Fed. 304 (1902), (58 L. R. A. 915).

That a complainant is a member of a combination in violation of the federal anti-trust act is no defence to suit for the infringement of a patent (*General Electric Co. v. Wise*, 119 Fed. 922 (1903)) or copyright (*Scribner v. Straus*, 130 Fed. 389 (1904)).

One who requests and accepts the services of a tug for towage purposes cannot escape paying the reasonable value of the services rendered by setting up that the owners of the tug were members of a combination in violation of the anti-trust statute.

The *Charles E. Wiswall*, 86 Fed. 671 (1898), *affirming* 74 Fed. 802 (1896).

for the protection of its rights under contracts entered into as the direct result of the unlawful combination.<sup>1</sup>

<sup>1</sup> In *Bement v. National Harrow Co.*, 186 U. S. 70 (1902), (22 Sup. Ct. Rep. 754), the Supreme Court said: "The plaintiff contends in the first place that only the Attorney-General of the United States can bring an action under the statute, excepting that by section 7 of the act any person injured in his business or property, as provided for therein, may himself sue in any circuit court of the United States in the district in which the defendant resides or is found. Assuming that the plaintiff is right so far as regards any suit brought under that act, we are nevertheless of opinion that any one sued upon a contract may set up as a defence that it is a violation of the act of Congress, and, if found to be so, that fact will constitute a good defence to the action."

In *Delaware, etc. R. Co. v. Frank*, 110 Fed. 689 (1901), a suit by a railroad company to enjoin the defendants, who were ticket brokers, from dealing in special non-transferable limited railroad tickets, it appeared upon a preliminary hearing that the complainant was a member of a combination known as the "Trunk Line Association," formed by a number of railroads operating in different States for the purpose of preventing competition and that the special rates upon such tickets and their terms were prescribed by such association. Judge Hazel held that the association was in violation of the federal anti-trust law and said: "The defendants do not deny the charges of wrongdoing. . . . But can the aid of a federal tribunal be invoked to protect the complainant in the issuance of a ticket over its railroad, which, as far as it appears to the court, is the culmination as well as the evidence of an agreement between railroad corporations specifically forbidden by an

act of Congress which has been sustained by the Supreme Court of the United States? . . . The complainant contends that this charge made by the defendant does not avail, as the wrong-doing, if any exists, does not relate to the subject-matter. I am not convinced as to the soundness of this contention. Can the railroad complainant conspire unlawfully to fix rates, and then come into a court of equity and invoke its aid to protect those rates which are represented by the ticket presented to the court, and which is wrongfully used by the defendants? The evil practice which stands admitted by the papers is the very practice for which the court's protection is invoked."

*Compare*, however, *Pennsylvania Co. v. Bay*, 138 Fed. 204 (1905), where a different conclusion was reached in a similar case.

Where an ancillary contract of the vendor of a business not to engage in a competing business for a specified period is entered into as a part of a plan for the formation of an unlawful combination it is held that it is itself in conflict with the statute and unenforceable.

*McConnell v. Camors-McConnell Co.*, 152 Fed. 321 (1907).

A combination of manufacturers and dealers in wall paper in violation of the federal statute was formed through the agency of a corporation which became the nominal seller of all the products of the combination although they were in fact sold by the different members. Certain dealers having been compelled to enter the combination purchased paper from various members of the combination for which the corporation — the nominal seller — brought suit. It was held that as the corporation was obliged to rely upon the agreement

§ 406. **Proceedings in Equity by Government. Injunctive Relief. Parties.** — The first three sections of the statute make certain acts and agreements criminal offences against the United States. The fourth section confers jurisdiction upon the circuit courts of the United States to restrain violations of the act, and declares it to be the duty of the several district attorneys "under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations." The fifth section provides for the citing in of additional parties; the sixth, for the forfeiture to the United States of certain property in course of transportation, and the eighth states a rule of construction. The only remedy afforded a private person is provided in the seventh section, which gives a party injured the right to recover threefold damages, costs and attorneys' fees.<sup>1</sup> The

of combination to show its right to sue, the invalidity of such agreement was a defence to the suit.

*Continental Wall Paper Co. v. Voight*, 148 Fed. 939 (1906).

Where a part of a contract sued upon is not severable from other parts which are in violation of the federal statute no recovery can be had upon it.

*Getz Bros. & Co. v. Federal Salt Co.*, 147 Cal. 115 (1905), (81 Pac. Rep. 416, 109 Am. St. Rep. 114).

<sup>1</sup>*Greer v. Stoller*, 77 Fed. 2 (1896), (*per Phillips, J.*): "Can a private citizen for a redress of a private grievance, maintain a bill in equity for an injunction under this act? The things forbidden by the act are declared to be criminal offences against the government of the United States. By the fourth section, the jurisdiction is conferred upon the circuit courts of the United States to prevent and restrain the violations of this act, 'and it shall be the duty of the several district attorneys of the United States in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations; such proceedings may be by way of petition

setting forth the case and praying that such violations shall be enjoined or otherwise prohibited.' Section 7 gives to the private person 'injured in his business or property by any other person or corporation by reason of anything forbidden, or declared to be unlawful by this act,' a right to sue in a circuit court of the United States in the district in which the defendant resides or is found for threefold damages by him sustained. The statute, being highly penal in its character, must be strictly construed; and, having created a new offence, and imposed new liabilities, and having provided the modes of redress to the public and the private citizen, by established rules of construction, these remedies are inclusive of all others. . . . My conclusion is that the right is limited by the fourth section to injunction at the relation of the district attorney, and that the seventh section gives to the private citizen his only remedy."

*Southern Indiana Exp. Co. v. United States Exp. Co.*, 88 Fed. 663 (1898), (*affirmed* 92 Fed. 1022), (1899): "The anti-trust law of July 2, 1890, has wrought no such change in the law as will enable the court to

statute, being penal in its nature, must be strictly construed. It imposes new liabilities and provides particular modes of redress, both for the public and the individual, and the methods so prescribed are exclusive. The United States, through its district attorneys, has the sole power to maintain a bill for an injunction to prevent a violation of the statute, and the only remedy of the individual is that provided by the statute.<sup>1</sup>

In proceedings for injunctive relief it is provided that a petition shall be filed setting forth the case, and praying that the alleged violation of the law may be enjoined or otherwise prohibited; that, after notice to the parties complained of, the court shall proceed as soon as may be to hear and determine the case, and that, pending petition and before final decree, it may make such temporary restraining order as may be just. In construing these provisions, it has been held that a restraining order may be issued without notice where, on account of the

enforce its provisions in favor of a private party by a bill in equity. Under this act, the only remedy given to any other party than the government of the United States is an action at law for threefold damages, with costs and attorney's fees, and the only party entitled to maintain a bill in equity for injunctive relief for an alleged violation of its provisions is the United States by its district attorney, on the authorization of its attorney-general."

See also *Bement v. National Harrow Co.*, 186 U. S. 87 (1902), (22 Sup. Ct. Rep. 747); *Post v. Southern R. Co.*, 103 Tenn. 184 (1899), (52 S. W. Rep. 301); *Metcalf v. American School-Furniture Co.*, 108 Fed. 909 (1901); *Block v. Standard Distilling, etc. Co.*, 95 Fed. 978 (1899); *Gulf, etc. R. Co. v. Miami Steamship Co.*, 86 Fed. 407 (1898); *Pidcock v. Harrington*, 64 Fed. 821 (1894); *Hagan v. Blindell*, 56 Fed. 696 (1893); *affirming Blindell v. Hagan*, 54 Fed. 40 (1893). *Compare, however, Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869 (1907).

<sup>1</sup> *United States v. Trans-Missouri*

*Freight Ass'n*, 166 U. S. 342 (1897), (17 Sup. Ct. Rep. 540): "It is urged that the United States have no standing in court to maintain this bill; that they have no pecuniary interest in the result of the litigation or in the question to be decided by the court. We think that the fourth section of the act invests the government with full power and authority to bring such an action as this, and, if the facts are proved, an injunction should issue. Congress, having the control of interstate commerce, has also the duty of protecting it, and it is entirely competent for that body to give the remedy by injunction as more efficient than any other civil remedy." See also *In re Debs*, 158 U. S. 564 (1895), (15 Sup. Ct. Rep. 900).

It has been held that an injunction order under the statute directed against a combination of railroad employees, is not rendered invalid by providing that it shall operate against persons not named in the bill but within the terms of the order. *United States v. Elliott*, 64 Fed. 27 (1894), 62 Fed. 801 (1894).

exigencies of the case, notice might be dispensed with according to established usages of equity practice.<sup>1</sup>

A proceeding in equity under the statute is a case arising under the Constitution and laws of the United States, and Congress may confer jurisdiction upon any federal court to hear it, regardless of the residence of the parties defendant. Consequently, the fifth section of the act, providing that when, in any pending proceeding, the interests of justice require it, parties residing outside the district may be brought in, is valid, and such parties may be served with process without the district. The proper practice is to make all parties — resident and non-resident — having an interest in the controversy, parties defendant to the bill, and, immediately upon filing it, to apply for an order of service upon the non-resident defendants. This order may be entered either before or after the service of process upon the resident defendants.<sup>2</sup>

In a proceeding by the government to restrain an alleged violation of the statute by an unincorporated association, it is sufficient that the association, its officers and a number of its members be made parties defendant.<sup>3</sup> This is in accordance with the rule that where parties are numerous, some of them may be cited in as representing the whole number.

§ 407. **Criminal Proceedings. Indictments. Parties.** — The first and third sections of the federal anti-trust statute in declaring contracts in restraint of interstate and interterritorial trade or commerce not only illegal, but criminal offences against the United States punishable by fine and imprisonment, go beyond the common law. Contracts in unreasonable restraint of trade, while invalid at common law as being contrary to public policy, were not criminal.<sup>4</sup> The other provisions of these sections, however, directed against conspiracies in restraint of interstate commerce, and the second section, imposing a penalty upon persons conspiring to monopolize such commerce, relate to a common law offence and extend the application of the law of

<sup>1</sup> *United States v. Coal Dealers' Ass'n*, 85 Fed. 252 (1898).

<sup>2</sup> *United States v. Standard Oil Co.*, 152 Fed. 290 (1907).

<sup>3</sup> *United States v. Coal Dealers' Ass'n*, 85 Fed. 260 (1898).

<sup>4</sup> *In re Greene*, 52 Fed. 104 (1892).

criminal conspiracies to combinations in restraint of interstate commerce.

The statute does not define what constitutes a contract, combination or conspiracy in restraint of trade or commerce, or what the term "monopolize" means, and recourse must be had to the common law and outside sources to obtain the proper definitions of those terms. The statute fails, moreover, to set forth all the elements necessary to constitute the several offences, and an indictment simply following the language of the statute, without stating the particular acts of the accused, would be insufficient.<sup>1</sup> An indictment must, therefore, be tested by the specific acts alleged to have been done or committed; and it must be distinctly averred that, by means of such acts, the designated offence against the freedom of interstate commerce was committed.<sup>2</sup>

An indictment for conspiracy should "describe something that amounts to a conspiracy under the act conformably to the rules of pleading at common law, as perhaps modified by general federal statutes."<sup>3</sup> The gist of the offence — the *combination* in restraint of interstate commerce — must be set forth, although the overt act may be omitted.<sup>4</sup>

An indictment sufficiently sets forth the time of the offence, which alleges when the several acts relied upon to show the combination were committed, without stating precisely when the unlawful purpose was formed.<sup>5</sup>

An indictment under the statute containing separate counts, one charging a combination in restraint of interstate commerce and the other, the monopolizing of such commerce, states distinct offences.<sup>6</sup>

<sup>1</sup> *In re Greene*, 52 Fed. 104 (1892); *United States v. Nelson*, 52 Fed. 646 (1892).

<sup>2</sup> *United States v. Greenhut*, 50 Fed. 469 (1892); *In re Corning*, 51 Fed. 205 (1892); *United States v. Nelson*, 52 Fed. 646 (1892); *In re Greene*, 52 Fed. 104 (1892); *United States v. Patterson*, 55 Fed. 605 (1893). See also *In re Terrell*, 51 Fed. 213 (1892). Compare *United States v. MacAndrews, etc. Co.*, 149 Fed. 823 (1906).

<sup>3</sup> *United States v. MacAndrews, etc. Co.*, 149 Fed. 823 (1906). See also *United States v. Debs*, 64 Fed. 747 (1894).

<sup>4</sup> See *ante*, § 325: "*Criminal and Civil Conspiracies distinguished.*"

<sup>5</sup> *United States v. MacAndrews, etc. Co.*, 149 Fed. 823 (1906).

<sup>6</sup> *United States v. MacAndrews, etc. Co.*, 149 Fed. 836 (1907).

In an indictment all the persons alleged to have violated the statute may be charged as principals. A corporation and its officers may be proceeded against jointly, and the latter, after having made the arrangements by which their corporation was to violate the act, cannot escape upon the claim that they were not personally engaged in interstate commerce.<sup>1</sup> Corporations are, however, themselves responsible for violations of the statute, and an indictment which charges a mere stockholder with the acts of his corporation is fatally defective.<sup>2</sup>

§ 408. **Actions by Government to enforce Forfeiture.** — The sixth section of the act provides for the forfeiture to the United States of property owned by an unlawful combination while in course of transportation from one State to another. The method of procedure under this statute follows that provided for the seizure, condemnation and forfeiture, of property unlawfully imported into the United States, and involves a trial by jury. There can be no seizure in a suit in equity for an injunction under the fourth section of the act.<sup>3</sup>

The locomotives and cars of a railroad carrier are not subject to forfeiture because it transports property shipped in violation of the statute. Simple transportation is not a contract, combination or conspiracy.<sup>4</sup>

<sup>1</sup> *United States v. MacAndrews, etc.* Co., 149 Fed. 823 (1906).

<sup>2</sup> *In re Greene*, 52 Fed. 104 (1892).

<sup>3</sup> *United States v. Addyston Pipe, etc. Co.*, 85 Fed. 271 (1898).

<sup>4</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 313 (1897), (17 Sup. Ct. Rep. 540): "Nor do we think that because the sixth section does not forfeit the property of the railroad company when merely engaged in the transportation of property owned under and which was the subject of a contract or combination mentioned in the first section, any ground is shown for holding the rest of the act inapplicable to carriers by railroad. It is not perceived why, if the rest of the act were intended to apply to such a carrier, the sixth section ought necessarily to have provided for the

seizure and condemnation of the locomotives and cars of the carrier engaged in the transportation between the States of those articles of commerce owned as stated in that sixth section. There is some justice and propriety in forfeiting those articles, but we see none in forfeiting the locomotives or cars of the carrier simply because such carrier was transporting articles as described from one State to another, even though the carrier knew that they had been manufactured or sold under a contract or combination in violation of the act. In the case of simple transportation of such articles the carrier would be guilty of no violation of any of the provisions of the act. Why, therefore, would it follow that the sixth section should provide for the for-

§ 409. **Actions for Treble Damages. Pleadings.** — At common law contracts and combinations in unreasonable restraint of trade — giving the phrase its modern meaning — were illegal in the sense, but only in the sense, of being unenforceable. Their invalidity prevented any action based upon them, but afforded no affirmative cause of action. The federal statute goes much further than the common law. It not only makes contracts and combinations in violation of its provisions *per se* unlawful, but gives a person injured thereby a private right of action for punitive damages.<sup>1</sup> The seventh section provides that any person injured in his business or property by anything forbidden or declared to be unlawful by the act may recover threefold his damages, costs and attorneys' fees.<sup>2</sup> An action upon the statute may be brought in any circuit court of the United States where the defendant resides or is found, without regard to the amount in controversy. As already shown, however, this action at law is the only remedy afforded a private person by the statute. The right to proceed in equity is granted only to the government.<sup>3</sup>

feiture of the property of the carrier if the rest of the act were intended to apply to it? To subject the locomotives and cars to forfeiture under such circumstances might also cause great confusion to the general business of the carrier, and, in that way, inflict unmerited punishment upon the innocent owners of other property in the course of transportation in the same cars and drawn by the same locomotives. If the company itself violates the act, the penalties are sufficient as provided for therein."

<sup>1</sup> *Wheeler-Stenzel Co. v. National Window Glass Jobbers' Ass'n*, 152 Fed. 873 (1907): "But it does not follow, as is argued by defendant that it does, that, because at common law contracts and combinations in restraint of trade were only illegal in the sense of being unenforceable, as being contrary to public policy, and that private wrongs cannot be predicated thereon, proper legislative authority has not, by making such con-

tracts and combinations absolutely unlawful, created a right of private action in one who has suffered in business or property thereby, even though such damage or loss would not have been actionable at common law."

<sup>2</sup> The amount of the attorneys' fees is within the discretion of the trial court, reasonably exercised.

*Montague v. Lowry*, 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307).

For consideration of constitutionality of a provision for the recovery of attorneys' fees, see *In re Grice*, 79 Fed. 627 (1897).

<sup>3</sup> See *ante*, § 406: "*Proceedings in Equity by Government. Injunctive Relief. Parties.*"

In *Leonard v. Abner-Drury Brewing Co.*, 25 App. D. C. 161 (1905), however, it was held that the fact that the statute makes a conspiracy in restraint of trade criminal does not prevent proceedings in equity where such conspiracy works or threatens



While the statute declares broadly that damages may be recovered for injuries sustained by reason of *any* violation of its provisions,<sup>1</sup> practically speaking a plaintiff, in order to state and establish a cause of action for substantial damages, must aver and show:

(1) That the defendants have entered into a combination or conspiracy to restrain or monopolize interstate or foreign commerce.<sup>2</sup>

(2) That he has been injured in his business or property by reason of specific acts of the defendants in pursuance of such combination or conspiracy.<sup>3</sup>

irreparable injury; that the statute affords new remedies but does not substitute them for those previously existing.

And in *Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869 (1907), it was held that a person claiming to be injured by a violation of the federal statute could, where the court had jurisdiction by reason of diversity of citizenship, sue for injunctive relief — that while the statute might not afford such relief in an action based strictly upon it, it was not the intention of the statute to *take away* existing remedies.

<sup>1</sup> Thus, for example, it is possible that a single corporation, by *monopolizing* interstate trade might inflict injuries for which damages could be recovered under the statute. But all the cases which have yet arisen under the seventh section of the act have been cases of combinations or conspiracies.

<sup>2</sup> In an action for damages under the statute a complaint is demurrable which fails to aver that the acts of the defendants complained of have some connection with a contract or combination in restraint of interstate commerce. *Bishop v. American Preservers Co.*, 51 Fed. 272 (1892), S. C. 105 Fed. 845 (1900). See also *Gibbs v. McNeeley*, 102 Fed. 599 (1900), S. C. 107 Fed. 210 (1901), 118 Fed. 120

(1902); *Ellis v. Inman*, 131 Fed. 182 (1904).

A manufacturer injured by a combination of labor organizations in restraint of interstate trade and commerce may maintain an action for treble damages under the seventh section of the act.

*Loewe v. Lawlor*, 208 U. S. 274 (1908), (28 Sup. Ct. Rep. 301).

<sup>3</sup> *Gibbs v. McNeeley*, 102 Fed. 599 (1900), S. C. 107 Fed. 210 (1901), 118 Fed. 120 (1902); *Lowry v. Tile, etc. Ass'n*, 106 Fed. 38 (1900), (*affirming* 98 Fed. 817 (1899)), S. C. *sub nom.* *Montague v. Lowry*, 115 Fed. 27 (1902), 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307).

*Rice v. Standard Oil Co.*, 134 Fed. 465 (1905): "It is apparent that mere proof that the defendant has entered into a contract or engaged in a combination or conspiracy in restraint of trade or commerce among the several States will not be sufficient to support a cause of action under the seventh section, for there must, in addition thereto, be proof that the plaintiff has, by reason thereof, sustained damage. In his declaration, therefore, the plaintiff must aver not only facts showing such a contract or combination or conspiracy as is declared by the act to be unlawful, but facts showing that by reason of such unlawful thing he has

(3) That the injury has involved actual, and not merely speculative, damage to his business or property.<sup>1</sup>

been injured in his business or property."

Section seven of the act does not authorize an action against an alleged trust or combination, by one who was a party to its organization and a stockholder therein, to recover damages resulting from the enforcement by defendant of rights given it by the alleged unlawful agreement. *Bishop v. American Preservers Co.*, 105 Fed. 845 (1900), S. C. 51 Fed. 272 (1892).

<sup>1</sup> In *Lowry v. Tile, etc. Ass'n*, 106 Fed. 46 (1900), *affirmed sub nom. Montague v. Lowry*, 115 Fed. 27 (1902), 193 U. S. 38 (1904), (24 Sup. Ct. Rep. 307) — an action for the recovery of damages under the seventh section — Judge Morrow charged the jury as follows: "Your verdict will be limited to the actual damages which the evidence shows the plaintiffs have sustained by reason of the acts of the defendants in violation of the act of Congress. The sole question, then, as to damages, in this case, relates to an injury which the plaintiffs may have sustained in their business by reason of the association in question. It is not enough, in an action of this kind, which is one at law, for the plaintiffs to establish the existence of an association which comes within the inhibition of the act of Congress. Plaintiffs must go still further, and the burden of proof is upon them to show some real and actual damage to their business by reason of such an association. . . . Mere speculation as to the possible profits of a mercantile business, in the absence of evidence directed to such conditions, cannot be indulged in by the jury for purposes of finding a verdict in damages. The damages which the law contemplates, and which the act of Congress provides

for, must be reasonable damages ascertainable upon the evidence presented in the case. There must be facts, transactions, actual evidence of some material and pertinent character, relating to a business from which the jury can ascertain with reasonable certainty that damage has actually been worked to such business, before any verdict in damages can be returned, other than nominal damages."

In *Whitwell v. Continental Tobacco Co.*, 125 Fed. 454 (1903), where the claim for damages was based upon the defendant's refusal to sell goods to the plaintiff, the Court said: "There is another reason why the complaint in this action fails to state facts sufficient to constitute a cause of action. The sole cause of the damages claimed in it is shown to be the refusal of the defendants to sell their goods to the plaintiff at prices which would enable him to resell them with a profit. Now, no act of omission of a party is actionable, no act or omission of a person causes legal injury to another, unless it is either a breach of contract with, or a duty to, him. The damages from other acts or omission form a part of that *damnum absque injuria* for which no action can be maintained or recovery had in the courts. The defendants had not agreed to sell their goods to the plaintiff at prices which would make their purchase profitable to him, so that the damages he suffered did not result from any breach of any contract with him. They were not caused by the breach of any legal duty to the plaintiff, for the defendants owed him no duty to sell their products to him at any price — much less, at prices so low that he could realize a profit by selling them again to others. The complaint, therefore, fails to show that

The fact that the injuries sustained by a violation of the statute are suffered wholly within a single State in no way prevents the recovery of damages therefor. Damage must nearly always be "in property, that is, in the money of the plaintiff, which is owned within some particular State."<sup>1</sup>

any legal injury or actionable damages were inflicted upon the plaintiff by the acts of the defendants."

Where a city brought suit for the recovery of damages under the seventh section of the act upon the ground that it had been compelled by an unlawful combination to pay more for articles purchased than they were reasonably worth, the Supreme Court of the United States (*Chattanooga Foundry, etc. Works v. City of Atlanta*, 203 U. S. 390, 396 (27 Sup. Ct. Rep. 65), *affirming* 127 Fed. 23 (1903), 101 Fed. 900 (1900)), said: "The facts gave rise to a cause of action under the act of Congress. The city was a person within the meaning of section 7, by the express provision of section 8. It was injured in its property, at least, if not in its business of furnishing water, by being led to pay more than the worth of the pipe. A person whose property is diminished by a payment of money wrongfully induced is injured in his property. The transaction which did the wrong was a transaction between parties in different States, if that be material. The fact that the defendant and others had combined with the seller led to the excessive charge, which the seller made in the interest of the trust by arrangement with its members, and which the buyer was induced to pay by the semblance of competition, also arranged by the members of the trust. One object of the combination was to prevent other producers than the Anniston Pipe and Foundry Company, the seller, from competing in sales to the plaintiff. There can be no doubt that Congress had power to give an action for damages to an

individual who suffers by breach of law."

General allegations in a declaration based upon the statute showing that as a result of the combination complained of the plaintiff has lost customers and has been prevented from making a profit in its legitimate business, as had been the case before the combination, are sufficient.

*Wheeler-Stenzel Co. v. National Window Glass Jobbers' Ass'n*, 152 Fed. 864 (1907).

Where foreign ship-owners formed a combination and granted rebates to parties who used their vessels exclusively in shipping from an American port, and the plaintiffs made shipments but lost their right to the rebates under the arrangement by shipping by other lines, it was held, in an action against the combination to recover damages under the seventh section, that the plaintiffs' substantial claim grew out of the withholding of the rebates which was not an item of damage growing proximately out of the combination and that they were not entitled to recover.

*Thomsen v. Union Castle Mail S. S. Co.*, 149 Fed. 933 (1907). The writ of error in this case to the U. S. Circuit Court of Appeals has not yet been passed upon.

For complaint describing an unlawful combination of lumber dealers and manufacturers and stating a cause of action for the recovery of damages under the seventh section of the act, see *Ellis v. Inman*, 131 Fed. 182 (1904).

<sup>1</sup> *Chattanooga Foundry, etc. Works v. City of Atlanta*, 203 U. S. 390, 397 (1906), (27 Sup. Ct. Rep. 65), *affirm-*

The recovery of treble damages under the seventh section must be by direct action and not by way of set-off in an action for the price of goods sold by the alleged unlawful combination.<sup>1</sup>

Upon the trial of an action for the recovery of threefold damages, the jury assess the actual damages sustained, and the court, in entering the judgment upon the verdict, trebles the amount.<sup>2</sup>

The declaration in an action for the recovery of damages must state the substantial facts relied upon to establish a violation of the act. It is not sufficient to follow the language of the statute.<sup>3</sup>

§ 410. **Limitations of Actions.** — The right of action for the recovery of treble damages under the seventh section of the statute is granted as a remedy for a private wrong and is compensatory in its purpose and effect — the damages allowed in excess of those actually sustained being regarded as exemplary. An action based upon the statute, therefore, being remedial rather than penal in its nature, is governed as to limitation by the statutes of the State where it is brought and not by the federal statute<sup>4</sup> prescribing a limitation of five years for a “suit or prosecution for any penalty or forfeiture, pecuniary or otherwise, accruing under the laws of the United States.”<sup>5</sup>

§ 411. **Effect of Voluntary Dissolution of Combination pending Proceedings.** — The equitable remedy afforded the government to restrain combinations in violation of the statute is for the protection of the rights of the public, and the relief granted should be adequate to the occasion. The mere dissolution of the unlawful combination may not be the most important part

*ing* 127 Fed. 23 (1903), 101 Fed. 900 (1900).

<sup>1</sup> *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540 (1902), (22 Sup. Ct. Rep. 431).

<sup>2</sup> *Lowry v. Tile, etc. Ass'n*, 106 Fed. 46 (1900).

<sup>3</sup> *Cilley v. United Shoe Mach. Co.*, 152 Fed. 726 (1907).

<sup>4</sup> U. S. Rev. Stat., § 1047.

<sup>5</sup> *Chattanooga Foundry, etc. Works v. City of Atlanta*, 203 U. S. 390 (1906), (27 Sup. Ct. Rep. 65), *affirming* 127

Fed. 23 (1903), 101 Fed. 900 (1900).

The fact that no federal statute is applicable leaves the matter of limitation to local law (U. S. Rev. Stat., § 721), and in the above case it was held that the ten year limitation of the Tennessee Code for all actions not expressly provided for controlled an action under the seventh section of the statute, rather than the three year limitation for injuries to real or personal property.

of the litigation. The essential question is the *validity* of the agreement, and the injunction prayed for may properly go so far as to enjoin the execution of similar agreements in the future.

In such a case, the dissolution of an unlawful association, after judgment and pending appeal, does not deprive the appellate court of jurisdiction.<sup>1</sup>

§ 412. **Proof of Violation of Statute. Evidence.** — In determining whether a particular contract or combination comes within the provisions of the federal statute, illegality is not to be presumed but must be proved.<sup>2</sup> It must be shown that the agreement, or the method of doing business thereunder, is in violation of the statute.

But where the necessary effect of an agreement, as shown upon its face, is to restrain interstate trade or commerce, the combination thereunder is illegal, and the question of the intent of the parties, in entering into it, is immaterial.<sup>3</sup> But where the

<sup>1</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 304 (1896), (17 Sup. Ct. Rep. 540): "Although the general rule is that equity does not interfere simply to restrain a possible future violation of law, yet, where parties have entered into an illegal agreement and are acting under it, and there is no adequate remedy at law and the jurisdiction of the court has attached by the filing of a bill to restrain such or any like action under a similar agreement, and a trial has been had, and judgment entered, the appellate jurisdiction of the court is not ousted by a simple dissolution of the association effected subsequently to the entry of judgment in the suit. Private parties may settle their controversies at any time, and rights which a plaintiff may have had at the time of the commencement of the action may terminate before judgment is obtained or while the case is on appeal, and in any such case, the court, being informed of the facts, will proceed no further in the action. Here, however, there has been no extinguishment of the rights (whatever they are) of the public, the enforce-

ment of which the government has endeavored to procure by a judgment of a court under the provisions of the act of Congress above cited. The defendants cannot foreclose those rights nor prevent the assertion thereof by the government, as a substantial trustee for the public under the acts of Congress, by any such action as has been taken in this case."

<sup>2</sup> See also *United States v. Workmen's Amalgamated Council*, 54 Fed. 994 (1893).

<sup>3</sup> *United States v. Addyston Pipe, etc. Co.*, 78 Fed. 723 (1897), (*reversed* 85 Fed. 271) (1898), 175 U. S. 121 (1899), (20 Sup. Ct. Rep. 96); *United States v. Trans-Missouri Freight Ass'n*, 58 Fed. 58 (1893), (*reversed* 166 U. S. 341) (1897), (17 Sup. Ct. Rep. 540). The reversals of the judgments of the lower courts in these cases in no way affects the principle stated in the text.

<sup>4</sup> *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 341 (1897), (17 Sup. Ct. Rep. 540): "Although the case is heard on bill and answer, thus making it necessary to assume the truth of the allegations in the answer which are well pleaded, yet

agreement, itself, does not establish the illegality of the combination, it may be shown by all the facts and circumstances of the case; and the practical working and effect of the defendant's methods of doing business may properly be considered.<sup>1</sup> In such a case, the objects, intent and purposes of the parties to the combination may be very material.<sup>2</sup>

In *Addyston Pipe, etc. Co. v. United States*,<sup>3</sup> the Supreme Court of the United States said: "It is the effect of the combination in limiting and restricting the right of each of the members to transact business in the ordinary way, as well as its effect upon the volume or extent of the dealing in the commodity, that is regarded. All the facts and circumstances are, however, to be considered in order to determine the fundamental question — whether the necessary effect of the combination is to restrain interstate commerce."<sup>4</sup>

the legal effect of the agreement itself cannot be altered by the answer, nor can its violation of law be made valid by allegations of good intention or of desire to simply maintain reasonable rates; nor can the plaintiffs' allegations as to the intent with which the agreement was entered into be regarded, as such intent is denied on the part of the defendants. And if the intent alleged in the bill were a necessary fact to be proved in order to maintain the suit, the bill would have to be dismissed. In the view we have taken of the question, the intent alleged by the government is not necessary to be proved. The question is one of law in regard to the meaning and effect of the agreement itself; namely, does the agreement restrain trade or commerce in any way so as to be a violation of the act? We have no doubt that it does."

<sup>1</sup> *United States v. Hopkins*, 82 Fed. 534 (1897), (*reversed* on other grounds, 171 U. S. 578 (1898), (19 Sup. Ct. Rep. 40)): "The first question, whether there is any combination in restraint of trade or commerce, or a combination to monopolize any part of trade or commerce, on the part of the de-

fendant association, is to be determined, not alone from what appears upon the face of its preamble, rules and by-laws, but from the entire situation and the practical working and results of the defendants' methods of doing business, as disclosed by the testimony in the case."

In *United States v. Workingmen's Amalgamated Council*, 54 Fed. 994 (1893), it was held that in order to sustain the allegations of a bill praying for an injunction against a combination in restraint of interstate commerce, the complainant might offer in evidence the official proclamation of the various government officers, and also newspaper reports, supported by affidavits, containing manifestos and declarations of the respondents.

<sup>2</sup> In *United States v. MacAndrews, etc. Co.*, 149 Fed. 836 (1907), it was held that a violation of the statute was shown where the evidence established the existence of a combination with intent to effect the restraint of interstate commerce.

<sup>3</sup> *Addyston Pipe, etc. Co. v. United States*, 175 U. S. 211 (1899), (20 Sup. Ct. Rep. 96).

<sup>4</sup> The facts stated or shown in the

§ 413. **Interpretation of Immunity Proviso.** — The proviso in the general appropriation act of 1903, already referred to,<sup>1</sup> that no person shall be prosecuted on account of anything which he may testify to in any proceeding under the federal anti-trust statute, is entitled to a sufficiently broad interpretation to protect a witness in disclosures made in pursuance of any judicial inquiry under the act. Accordingly, it is held that the examination of a witness before a grand jury is a "proceeding" within the meaning of the proviso.<sup>2</sup>

The practical effect of the proviso is to take a witness testifying in any proceeding under the federal statute out of the operation of the Fifth Amendment.<sup>3</sup> If he cannot be prosecuted on account of his testimony, he is not incriminated by his testimony. And notwithstanding that the immunity may not extend to prosecutions in a State court, he cannot refuse to testify. In granting immunity "the only danger to be considered is one arising within the same jurisdiction and under the same sovereignty."<sup>4</sup>

The same principles apply to written as to oral testimony. A witness who cannot set up the Fifth Amendment as to oral testimony on account of the immunity granted by the proviso, cannot avail himself of it to prevent the production of books and papers.<sup>5</sup>

The Fifth Amendment is for the personal protection of the witness, and he cannot set it up in a proceeding under the statute in behalf of a corporation of which he may be the agent or representative. With respect to testimony concerning the affairs of his corporation, the immunity proviso is inapplicable. If the witness has no constitutional right to decline to give such testimony, there is no reason why he should be protected in giving it.<sup>6</sup>

recent important cases of United States v. MacAndrews, etc. Co., 149 Fed. 823, 836 (1907), and United States v. Standard Oil Co., 152 Fed. 292 (1907), should be examined in considering the evidence tending to establish combinations and conspiracies contrary to the federal statute.

<sup>1</sup> See *ante*, § 385.

<sup>2</sup> *Hale v. Henkel*, 201 U. S. 43 (1906), (26 Sup. Ct. Rep. 370).

<sup>3</sup> The Fifth Amendment is printed in note to § 420, *post*.

<sup>4</sup> *Hale v. Henkel*, 201 U. S. 43 (1906), (26 Sup. Ct. Rep. 370).

<sup>5</sup> *Hale v. Henkel*, 201 U. S. 43 (1906), (26 Sup. Ct. Rep. 370).

<sup>6</sup> In *Hale v. Henkel*, 201 U. S. 43, 69 (1906), (26 Sup. Ct. Rep. 370),

## II

## STATE ANTI-TRUST STATUTES

## CHAPTER XLI

## STATE STATUTES AND THEIR CONSTITUTIONALITY

- § 414. The Statutes. Development of State Legislation.
- § 415. Sphere of State Legislation. Operation of Commerce Clause of the Constitution.
- § 416. Controlling Propositions in determining Constitutionality of State Statutes.
- § 417. Power of State to prohibit Combinations of Quasi-public Corporations. Power over Property devoted to Public Uses.
- § 418. Power of State to prohibit Combinations of Corporations in Exercise of Reserved Power.
- § 419. Validity of State Statutes tested by Fourteenth Amendment — (A) Right to Contract.
- § 420. Validity of State Statutes tested by Fourteenth Amendment — (B) Police Power of the State.
- § 421. Validity of State Statutes tested by Fourteenth Amendment — (C) Class Legislation.
- § 422. Validity of State Statutes under State Constitutional Provisions.
- § 423. State Courts' Interpretation of State Statute followed by Federal Courts in determining its Constitutionality.
- § 424. Who may question Constitutionality of Statutes.

§ 414. The Statutes. Development of State Legislation. —  
A summary of the State laws against combinations — commonly

the Supreme Court of the United States said: "But it is further insisted that while the immunity statute may protect individual witnesses, it would not protect the corporation of which appellant was the agent and representative. This is true, but the answer is that it was not designed to do so. The right of a person under the Fifth Amendment to refuse to incriminate himself is purely a personal privilege of the witness. It was never intended to permit him to plead the fact that some third person might be incriminated by his testi-

mony, even though he were the agent of such person. A privilege so extensive might be used to put a stop to the examination of every witness who was called upon to testify before the grand jury with regard to the doings or business of his principal, whether such principal were an individual or a corporation. The question whether a corporation is a 'person' within the meaning of this Amendment really does not arise, except, perhaps, where a corporation is called upon to answer a bill of discovery, since it can only be heard by



called "anti-trust" acts — is printed in the subjoined note.<sup>1</sup>

oral evidence, in the person of some one of its agents or employees. The Amendment is limited to a person who shall be compelled in any criminal case to be a witness against *himself*, and if he cannot set up the privilege of a third person, he certainly cannot set up the privilege of a corporation. As the combination or conspiracies provided against by the Sherman Anti-Trust Act can ordinarily be proved only by the testimony of parties thereto, in the person of their agents or employees, the privilege claimed would practically nullify the whole act of Congress. Of what use would it be for the legislature to declare these combinations unlawful if the judicial power may close the door of access to every available source of information upon the subject? Indeed, so strict is the rule that the privilege is a personal one that it has been held in some cases that counsel will not be allowed to make the objection."

See also *McAlister v. Henkel*, 201 U. S. 90 (1906), (26 Sup. Ct. Rep. 385).

<sup>1</sup> *Alabama*. Crim. Code 1907, ch. 273, § 7579: "Any person or corporation, who engages or agrees with other persons or corporations, or enters into, directly or indirectly, any combination, pool, trust, or confederation, to regulate or fix the price of any article or commodity to be sold or produced within this State; or any person or corporation who enters into, becomes a member of, or party to, any pool, agreement, combination, or confederation to fix or limit the quantity of any article or commodity to be produced, manufactured, mined, or sold in this State, must, on conviction, be fined not less than five hundred nor more than two thousand dollars."

*Ib.* § 7580: "Any corporation

chartered under the laws of this State, or any officer, stockholder, agent, or employee of any such corporation, which enters into any combination with any other corporation or person with the intent to place the management or control of any such corporation in the hands of another corporation or person, and thereby limit or fix the price, or restrict or diminish the production, manufacture, sale, use, or consumption of any article of commerce, must, on conviction, be fined not less than five hundred nor more than two thousand dollars."

*Arkansas*. Const. Art. II. § 19: "Perpetuities and monopolies are contrary to the genius of a republic, and shall not be allowed. . ."

Acts of 1905. Act 1, § 1: "Any corporation organized under the laws of this or any other State, or country, and transacting or conducting any kind of business in this State, or any partnership or individual, or other association or persons whatsoever, who are now, or shall hereafter create, enter into, become a member of, or a party to, any pool, trust, agreement, combination, confederation or understanding, whether the same is made in this State or elsewhere, with any other corporation, partnership, individual, or any other person or association of persons, to regulate or fix either in this State or elsewhere the price of any article of manufacture, mechanism, merchandise, commodity, convenience, repair, any product of mining, or any article or thing whatsoever, or the price or premium to be paid for insuring property against loss or damage by fire, lightning or tornado, or to maintain said price when so regulated or fixed, or who are now, or shall hereafter enter into, become a member of, or a party to any pool, agreement, contract, com-

These statutes have followed as the inevitable result of the working of the laws of trade in the face of an adverse public

bination, association or confederation, whether made in this State or elsewhere, to fix or limit in this State or elsewhere, the amount or quantity of any article of manufacture, mechanism, merchandise, commodity, convenience, repair, any product of mining, or any article or thing whatsoever, or the price or premium to be paid for insuring property against loss or damage by fire, lightning, storm, cyclone, tornado or any other kind of policy issued by any corporation, partnership, individual or association of persons aforesaid, shall be deemed and adjudged guilty of a conspiracy to defraud and be subject to the penalties as provided by this act."

§ 5: "A monopoly is any union or combination or consolidation or affiliation of capital, credit, property, assets, trade, customs, skill or acts of any other valuable thing or possession, by or between persons, firms or corporations, whereby any one of the purposes or objects mentioned in this act is accomplished or sought to be accomplished, or whereby any one or more of said purposes are promoted or attempted to be executed or carried out, or whereby the several results described herein are reasonably calculated to be produced; and a monopoly, as thus defined and contemplated, includes not merely such combination by and between two or more persons, firms and corporations, acting for themselves, but is especially defined and intended to include all aggregations, amalgamations affiliations, consolidations, or incorporations of capital, skill, credit, assets, property, custom, trade, or other valuable thing or possession whether effected by the ordinary methods of partnership or by actual union under the legal form of a corporation, or

any incorporated body resulting from the union of one or more distinct firms or corporations, or by the purchase, acquisition or control of shares or certificates of stocks or bonds, or other corporate property or franchises, and all partnerships or corporations that have been or may be created by the consolidation or amalgamation of the separate capital, stocks, bonds, assets, credit, property, customs, trade, corporate or firm belongings of two or more firms or corporations or companies, are especially declared to constitute monopolies within the meaning of this act if so created or entered into for any one or more of the purposes named in this act; and a monopoly, as thus defined in this section, is hereby declared to be unlawful and against public policy, and any and all persons, firms, corporations, or associations of persons engaged therein, shall be deemed and adjudged to be guilty of a conspiracy to defraud, and shall be subject to the penalties prescribed in this act.

§ 6: "If any person, persons, company, partnership, association, corporation or agent engaged in the manufacture or sale of any article of commerce or consumption produced, manufactured or mined in this State, or elsewhere, shall, with the intent and purpose of driving out competition, or for the purpose of financially injuring competitors, sell within the State at less than cost of manufacture or production, or sell in such a way, or give away in this State, their productions for the purpose of driving out competition, or financially injuring competitors engaged in similar business, said person or persons, company, partnership, association, corporation, or agent resorting to this method of securing a monopoly within this

policy. As pointed out in the preliminary part of this treatise, the modern tendency of business is toward combination — the

State in such business shall be deemed guilty of a conspiracy to form or secure a trust or monopoly in restraint of trade, and on conviction thereof shall be subjected to the penalties of this act."

The other sections of the act relate to penalties, remedies and procedure. For penalties, see *post*, §§ 447, 448.

*California.* "Cartwright Anti-Trust Bill," approved March 23, 1907:

§ 1. "A trust is a combination of capital, skill or acts by two or more persons, firms, partnerships, corporations or associations of persons, or of any two or more of them for either, any or all of the following purposes:

1. To create or carry out restrictions in trade or commerce.

2. To limit or reduce the production, or increase or reduce the price of merchandise or of any commodity.

3. To prevent competition in manufacturing, making, transportation, sale or purchase of merchandise, produce or any commodity.

4. To fix at any standard or figure, whereby its price to the public or consumer shall be in any manner controlled or established, any article or commodity of merchandise, produce or commerce intended for sale, barter, use or consumption in this State.

5. To make or enter into or execute or carry out any contracts, obligations or agreements of any kind or description, by which they shall bind or have bound themselves not to sell, dispose of or transport any article or any commodity or any article of trade, use, merchandise, commerce or consumption below a common standard figure, or fixed value, or by which they shall agree in any manner to keep the price of such article, commodity or transportation at a fixed or graduated figure, or by which they shall in

any manner establish or settle the price of any article, commodity or transportation between them or themselves and others, so as to directly or indirectly preclude a free and unrestricted competition among themselves, or any purchasers or consumers in the sale or transportation of any such article or commodity, or by which they shall agree to pool, combine or directly or indirectly unite any interests that they may have connected with the sale or transportation of any such article or commodity, that its price might in any manner be affected. Every such trust as is defined herein is declared to be unlawful, against public policy, and void."

The remaining sections of the bill relate to remedies, penalties and procedure. For penalties, see *post*, § 447.

*Florida.* Laws 1897, ch. 4534, relates only to combinations to obstruct the sale of meat or edible live stock in the State. For penalties see *post*, §§ 446, 448.

*Georgia.* Constitutional provision (Art. IV. § 2, par. 4) against agreements for prevention of competition appears *ante*, § 32 *n*.

The Georgia anti-trust act of December 23, 1896 (Supp. to Code 1901, § 6467), was held to be unconstitutional by the Supreme Court of that State in *Brown v. Jacobs' Pharmacy Co.*, 115 Ga. 429 (1902), (41 S. E. Rep. 553, 90 Am. St. Rep. 126, 57 L. R. A. 547).

For consideration of the constitutional question involved, see *post*, § 421.

*Illinois.* Meyer's Ill. Stat. 1898, ch. 140 b (Act of June 11, 1891, as amended by Laws 1897, p. 298): (1) "If any corporation organized under the laws of this or any other

unification of interests and concentration of control. During the past twenty years — especially during the past decade —

State or country, for transacting or conducting any kind of business in this State, or any partnership or individual or other association of persons whatsoever, shall create, enter into, become a member of or a party to any pool, trust, agreement, combination, confederation or understanding with any other corporation, partnership, individual or any other person or association of persons, to regulate or fix the price of any article of merchandise or commodity, or shall enter into, become a member of or a party to any pool, agreement, contract, combination or confederation to fix or limit the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold in this State, such corporation, partnership or individual or other association of persons shall be deemed and adjudged guilty of a conspiracy to defraud, and be subject to indictment and punishment as provided in this act: *Provided, however*, That in the mining, manufacture or production of articles of merchandise, the cost of which is mainly made up of wages, it shall not be unlawful for persons, firms or corporations doing business in this State to enter into joint arrangements of any sort, the principal object or effect of which is to maintain or increase wages.

(2) "It shall not be lawful for any corporation to issue or to own trust certificates, or for any corporation, agent, officer or employees, or the directors or stockholders of any corporation, to enter into any combination, contract or agreement with any person or persons, corporation or corporations, or with any stockholder or director thereof, the purpose and effect of which combination, contract or agreement shall be to place the management or control of such com-

bination or combinations, or the manufactured product thereof, in the hands of any trustee or trustees, with the intent to limit or fix the price or lessen the production and sale of any article of commerce, use or consumption, or to prevent, restrict or diminish the manufacture or output of any such article."

(3) All contracts or agreements in violation of any provision of this act are absolutely void.

For provision that act may be pleaded as a defence see *post*, § 445.

For penalties against corporations and individuals, see *post*, §§ 446, 448.

The later Illinois anti-trust act of June 20, 1893 (Starr and Curtis Ann. Stat. ch. 38, par. 109), has been declared unconstitutional by the Supreme Court of the United States. See *post*, § 421. The proviso in the Act of 1891, with respect to combinations regarding wages has also been declared unconstitutional by the Illinois Supreme Court. See *post*, § 421.

*Indiana.* Laws 1907, ch. 243, § 1: "That every scheme, design, understanding, contract, combination in the form of a trust or otherwise, or conspiracy in restraint of trade, or commerce, or to create or carry out restrictions in trade or commerce, or to deny or refuse to any person or persons full participation, on equal terms with others, in any telegraphic service transmitting matter prepared or intended for public use, or to limit or reduce the production, or increase or reduce the price of merchandise or any commodity, natural or artificial, or to prevent competition in manufacturing, within or without this State, is hereby declared to be illegal, but none of the provisions of this act shall be construed to apply to [or] repeal, modify or limit, or make

the great producing industries of the country have come under the control of a comparatively few corporations with vast

unlawful any of the powers, rights or privileges now existing or conferred by law upon any person, copartnership, association or corporation. Every person who shall make any such contract or engage in any such combination or conspiracy, or enter into any such scheme, design or understanding, or do within this State any act in furtherance of any such contract, combination, conspiracy, scheme, design or understanding, entered into without this State, shall be deemed guilty of a misdemeanor, and on conviction thereof shall be fined in any sum not exceeding five thousand dollars, to which may be added imprisonment in the county jail or workhouse for a term not exceeding one year in the discretion of the court or jury trying the cause: *Provided, however*, That it shall be a good defence to any action growing out of any violation of the provisions of this act or any other act or common law relating to the subject-matter of this Act if the defendant shall plead and by a fair preponderance of the evidence prove that such violation is not in restraint of trade or commerce or does not restrict trade or commerce or limit or reduce the production or increase or reduce the price of merchandise or any commodity natural or artificial or prevent competition in manufacturing.

§ 2. "Every person who shall monopolize or attempt to monopolize or combine or conspire with any other person or persons to monopolize any part of the trade or commerce within this State, shall be deemed guilty of a misdemeanor, and on conviction thereof shall be fined in any sum not exceeding five thousand dollars, to which may be added imprisonment in the county jail or workhouse for a term not exceeding one year in the

discretion of the court or jury trying the cause."

§ 12. "The provisions of this act shall be held cumulative of or supplemental to each other, and of all other laws in any way affecting them, or any matter which in any manner is the subject of this act in this State, and cumulative of and supplemental to the common law of this State relative thereto, or to any thereof."

The other provisions of the act relate to combinations to prevent competition for public contracts, remedies and procedure.

For other Indiana anti-trust statutes, see Horner's Anno. Stat. 1901, §§ 7554, 7556, 7557 (Act of March 5, 1897); § 7559 *a* (Act of March 3, 1889), and § 7559 *f* (Act of March 8, 1901).

*Iowa.* Code 1897, § 5060: "Any corporation organized under the laws of this or any other State or country for transacting or conducting any kind of business in this State, or any partnership, association or individual, creating, entering into or becoming a member of or a party to any pool, trust, agreement, contract, combination, confederation or understanding with any other corporation, partnership, association or individual, to regulate or fix the price of any article of merchandise or commodity, or to fix or limit the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold in this State, shall be guilty of a conspiracy."

*Kansas.* Rev. Stat. 1899, ch. 113 *a* (Act of 1897): "A trust is a combination of capital, skill or acts, by two or more persons, firms, corporations, or associations of persons, or either two or more of them, for either, any or all of the following purposes:

capital and almost unlimited resources. And one of the objects — perhaps the primary object — of these combinations has been the elimination of competition.

*"First.* To create or carry out restrictions in trade or commerce or aids to commerce, or to carry out restrictions in the full and free pursuit of any business authorized or permitted by the laws of this State.

*"Second.* To increase or reduce the price of merchandise, produce or commodities, or to control the cost of rates of insurance.

*"Third.* To prevent competition in the manufacture, making, transportation, sale or purchase of merchandise, produce or commodities, or to prevent competition in aids to commerce.

*"Fourth.* To fix any standard or figure, whereby its price to the public shall be, in any manner, controlled or established, any article or commodity of merchandise, produce or commerce intended for sale, use or consumption in this State.

*"Fifth.* To make or enter into, or to execute or carry out, any contract, obligation or agreement of any kind or description by which they shall bind or have to bind themselves not to sell, manufacture, dispose of or transport any article or commodity, or articles of trade, use, merchandise, commerce or consumption below a common standard figure or by which they shall agree in any manner to keep the price of such article, commodity, or transportation at a fixed or graded figure, or by which they shall in any manner establish or settle the price of any article or commodity or transportation between them or themselves and others, to preclude a free and unrestricted competition among themselves or others in transportation, sale or manufacture of any such article or commodity, or by which they shall agree to pool, combine or unite any interest they may have in con-

nection with the manufacture, sale or transportation of any such article or commodity, that its price may in any manner be affected. And any such combinations are hereby declared to be against public policy, unlawful and void."

For provision that act may be pleaded as defence see *post*, § 445.

For penalties against corporations and individuals see *post*, §§ 446, 447, 448.

For another Kansas anti-trust statute, see Gen. Stat. 1899, § 2377.

*Kentucky.* Const. § 198: "It shall be the duty of the General Assembly, from time to time, as necessity may require, to enact such laws as may be necessary to prevent all trusts, pools, combinations or other organizations, from combining to depreciate below its real value any article, or to enhance the cost of any article above its real value."

Carroll's Stat. 1903, ch. 101, § 3915 (Act of 1890): "If any corporation under the laws of Kentucky, or under the laws of any other State or country, for transacting or conducting any kind of business in this State, or any partnership, company, firm or individual, or other association of persons, shall create, establish, organize or enter into, or become a member of, or a party to, or in any way interested in, any pool, trust, combine, agreement, confederation or understanding with any other corporation, partnership, individual or person, or association of persons, for the purpose of regulating or controlling or fixing the price of any merchandise, manufactured articles or property of any kind, or shall enter into, become a member of, or party to, or in any way interested in, a pool, agreement, contract, understanding, combination or confederation, having

Yet neither the courts, the legislatures nor the people in general have ever relaxed in their belief that "competition is the

for its object the fixing, or in any way limiting, the amount or quantity of any article of property, commodity or merchandise to be produced or manufactured, mined, bought or sold, shall be deemed guilty of the crime of conspiracy." The act contains provisions similar to those of the Illinois statute, *supra*, concerning trust certificates and trustees, and the invalidity of contracts. For provision that act may be pleaded as a defence, see *post*, § 445. For penalties against corporations and individuals see *post*, §§ 446, 448.

*Louisiana.* Const. Art. CXC: "It shall be unlawful for persons or corporations, or their legal representatives, to combine or conspire together, or to unite or pool their interests, for the purpose of forcing up or down the price of any agricultural product or article of necessity for speculative purposes; and the legislature shall pass laws to suppress it."

Const. and Rev. Laws (Wolff) 1904, p. 1804: "After the passage of this act, it shall be unlawful for any individual, firm, company, corporation or association to enter into, continue or maintain any combination, agreement or arrangement of any kind, expressed or implied, with any other individual, firm, company, association or corporation for any of the following purposes: *First*, to create or carry out restrictions in trade. *Second*, to limit or reduce the production, or increase or reduce the price, of merchandise, produce or commodities. *Third*, to prevent competition in manufacture, making, transportation, sale or purchase of merchandise, produce, or commodities. *Fourth*, to fix at any standard of figure, whereby its price shall be in any manner controlled or established, any article of merchandise, produce, commodity or

commerce intended for consumption in this State. *Fifth*, to make or enter into or execute or carry out any contract, obligation or agreement of any kind or description by which they shall bind or have bound themselves not to sell, dispose of or transport any article or commodity, or article of trade, use, merchandise, commerce or consumption below a common standard figure, or by which they shall agree in any manner to keep the price of such article at a fixed or graduated figure, or by which they shall, in any manner, establish or settle the price of any article or commodity or transportation between them, or themselves and others, to preclude a free and unrestricted competition among themselves or others in the sale or transportation of any such article or commodity, or by which they shall agree to pool, combine or unite any interest they may have in connection with the sale or transportation of any such article or commodity that its price might in any manner be affected."

For penalties against corporations and individuals see *post*, §§ 446, 448.

Louisiana has also another statute directed against combinations in restraint of *domestic* trade and commerce which is, apparently, modelled after the federal anti-trust act (Const. and Rev. Laws (Wolff) 1904, p. 1800).

*Maine.* Rev. Stat., ch. 47, § 53: "It shall be unlawful for any firm or incorporated company, or any number of firms or incorporated companies, or any unincorporated company, or association of persons or stockholders, organized for the purpose of manufacturing, producing, refining or mining any article or product which enters into general use and consumption by the people, to form or organize any trust, or to enter into

life of trade." Combinations for the purpose of stifling competition, as we have seen, have always been declared contrary to

any combination of firms, incorporated or unincorporated companies, or association of stockholders, or to delegate to any one or more board or boards of trustees or directors the power to conduct and direct the business of the whole number of firms, corporations, companies or associations which may have, or which may propose to form, a trust, combination, or association inconsistent with the provisions of this section and contrary to public policy.

§ 54: "No certificate of stock, or other evidence of interest, in any trust, combination or association, as named in the preceding section, shall have legal recognition in any court in this State, and any deed to real estate given by any person, firm or corporation, for the purpose of becoming interested in such trust, combination or association, or any mortgage given by the latter to the seller, as well as all certificates growing out of such transaction, shall be void.

§ 55: "Any firm, incorporated or unincorporated company or association of persons or stockholders, who shall enter into or become interested in such trust, combination or association, shall be subject to a fine of not less than five, nor more than ten thousand dollars."

*Maryland.* Declaration of Rights, Art. XLI: "Monopolies are odious, contrary to the spirit of free government and the principles of commerce, and ought not to be suffered."

*Michigan.* Public Act 1899, No. 255 defines a trust in substantially the same language as the Kansas statute, *supra*. It declares every trust, as so defined, unlawful, against public policy, and void; that any violation of the act is "a conspiracy against trade," and that any person engaging in such conspiracy shall be punished

by a fine or imprisonment, or both. Charters of domestic corporations violating the act are subject to forfeiture, and foreign corporations may be excluded from the State. The act also contains provisions similar to those in the Illinois statute (*supra*) concerning trust certificates, trustees and the invalidity of contracts in violation of the act. For further statement of penalties see *post*, § 446.

The Michigan statute of 1905 (No. 329), supplementing the act of 1899, follows: § 1: "All agreements and contracts by which any person, copartnership or corporation promises or agrees not to engage in any avocation, employment, pursuit, trade, profession or business, whether reasonable or unreasonable, partial or general, limited or unlimited, are hereby declared to be against public policy and illegal and void.

§ 2: "All combinations of persons, copartnerships, or corporations made and entered into for the purpose and with the intent of establishing and maintaining or of attempting to establish and maintain a monopoly of any trade, pursuit, avocation, profession or business, are hereby declared to be against public policy and illegal and void.

§ 3: "Any corporation organized under the laws of this State for the purpose of establishing and maintaining, or attempting to establish or maintain, any combination of persons, copartnerships or corporations with intent to establish and maintain or of attempting to establish and maintain a monopoly of any trade, pursuit, avocation, profession or business, is hereby declared to be against public policy and illegal and void.

§ 4: "Any foreign corporation organized for the purpose and with the intent of establishing and maintaining



public policy. But the common law was inefficient in dealing with combinations. It merely let the agreements alone. They

or of attempting to establish and maintain a monopoly of any trade, pursuit, avocation, profession or business, is hereby prohibited from doing business in this State, and any permission or authority heretofore obtained by any such corporation to do business in this State is hereby declared to be illegal and void.

§ 5: "This act shall apply to agreements, contracts and combinations in restraint of trade or commerce heretofore entered into or made, and which are sought to be enforced or maintained after this act takes effect; and all contracts and agreements in violation of this act heretofore made, expressly or impliedly, continuing in force after this act takes effect, are hereby declared to be against public policy and illegal and void.

§ 6: "This act shall not apply to any contract mentioned in this act nor in restraint of trade, where the only object of the restraint imposed by the contract is to protect the vendee or transferee of a trade, pursuit, avocation, profession or business, or the good will thereof, sold and transferred for a valuable consideration in good faith and without any intent to create, build up, establish or maintain a monopoly."

*Minnesota.* Rev. Laws, § 5168: "No person or association of persons shall enter into any pool, trust, agreement, or understanding whatsoever with any other person or association, corporation or otherwise, in restraint of trade, within this State, or between the people of this or any other State or country, or which tends in any way or degree to limit, fix, control, maintain, or regulate the price of any article of trade, manufacture, or use bought and sold within the State, or which limits or tends to limit the production of any such article, or which

prevents or limits competition in the purchase and sale thereof, or which tends or is designed so to do. Every person violating any provision of this section, or assisting in such violation, shall be guilty of a felony, and upon conviction thereof shall be punished by a fine of not less than five hundred dollars nor more than five thousand dollars, or by imprisonment in the State prison for not less than three nor more than five years."

For provision concerning forfeiture of franchises of corporations violating statute, see *post*, § 448.

Session Laws 1907, ch. 252, prohibit combinations with respect to the sale of grain. *Ib.* ch. 269, prohibit unfair discrimination and competition in the sale of petroleum and its products.

*Mississippi.* Const. § 198: "The legislature shall enact laws to prevent all trusts, combinations, contracts and agreements inimical to the public welfare."

Laws 1900, ch. 88, § 11 (see Code 1906, § 5002): "A trust and combine is a combination, contract, understanding or agreement, expressed or implied, between two or more persons, corporations, or firms or associations of persons, or between one or more of either with one or more of the others; (a) in restraint of trade; (b) to limit, increase or reduce the price of a commodity; (c) to limit, increase or reduce the production or output of a commodity; (d) intended to hinder competition in the production, importation, manufacture, transportation, sale or purchase of a commodity; (e) to engross or forestall a commodity; (f) to issue, own or hold the certificates of stock of any trust or combine; (g) to place the control, to any extent, of business or of the products or earnings thereof, in the

were unlawful in the sense of being unenforceable, but they were not unlawful in the sense of affording a ground of action

power of trustees, by whatever name called; (h) by which any other person than themselves, their proper officers, agents and employees shall, or shall have the power to, dictate or control the management of business; or (i) to unite or pool interests in the importation, manufacture, production, transportation or price of a commodity; and is inimical to the public welfare, unlawful, and a criminal conspiracy.

§ 2: "Any corporations, domestic or foreign, which shall restrain or attempt to restrain the freedom of trade or production; or which shall monopolize or attempt to monopolize the production, control or sale of any commodity, or the prosecution, management or control of any kind, class or description of business; or which shall engross or forestall or attempt to engross or forestall any commodity; or which shall destroy competition in the manufacture or sale of a commodity, by offering the same for sale at a price below the normal cost of production, shall be deemed a trust and combine within the meaning and purpose of this Act, shall be liable to all the pains, penalties, fines, forfeitures, judgments and recoveries herein denounced against trusts or combines, and shall be proceeded against in manner and form provided in this Act in case of other trusts and combines."

The act further declares all contracts in violation of its provisions void and prescribes penalties against corporations and individuals. (See *post*, § 446.) It also provides that no corporation shall purchase the stock or the franchises, plants, etc., of any competing corporation, and that corporations shall not engage in business not authorized by their charters.

*Missouri*. Rev. Stat. 1899, as amended in 1907, § 8965: "Any person who shall create, enter into, become a member of or participate in any pool, trust, agreement, combination, confederation or understanding with any person or persons in restraint of trade or competition in the importation, transportation, manufacture, purchase or sale of any product or commodity in this State, or any article or thing bought or sold whatsoever, shall be deemed and adjudged guilty of a conspiracy in restraint of trade, and shall be punished as provided in this act.

§ 8966: "Any person who shall create, enter into, become a member of or participate in any pool, trust, agreement, combination, confederation or understanding with any other person or persons to regulate, control, or fix the price of any article of manufacture, mechanism, merchandise, commodity, convenience or repair, or any product of mining, or any article or thing whatsoever, of any class or kind bought and sold, or the price or premium to be paid for insuring property against loss or damage by fire, lightning or storm, or to maintain said price when so regulated or fixed, or shall enter into, become a member of or participate in any pool, trust, agreement, contract, combination, confederation or understanding, to fix or limit the amount [or] quantity of any article of manufacture, mechanism, commodity, convenience, repair, any product of mining, or any article or thing whatsoever of any class or kind bought and sold, or the price or premium to be paid for insuring property against loss or damage by fire, lightning or storm, shall be deemed and adjudged guilty of a conspiracy in restraint of trade, and be punished as provided for in this act.

to a person injured. *A fortiori* they were not criminal. The federal anti-trust statute went, as has been shown, far beyond

§ 8967: "Any two or more persons engaged in buying or selling any article of commerce, manufacture, mechanism, commodity, convenience, repair, any product of mining, or any article or thing of any class or kind whatsoever, who shall create, enter into, become members of or participate in any pool, trust, agreement, combination, confederation, association or understanding to control or limit the trade in any such article or thing, or to limit competition in such trade by refusing to buy from or sell to any other person any such article or thing aforesaid, for the reason that such other person is not a member of or a party to such pool, trust, combination, confederation, association or understanding, or shall boycott or threaten any person from buying or selling to any other person who is not a member of or a party to such pool, trust, agreement, combination, confederation, association or understanding in such article or thing aforesaid, shall be deemed and adjudged guilty of a conspiracy in restraint of trade, and punished as provided for in this act.

§ 8968: "All arrangements, contracts, agreements, combinations or understandings made, or entered into between any two or more persons, designed or made with a view to lessen, or which tend to lessen, lawful trade, or full and free competition in the importation, transportation, manufacture or sale in this State of any product, commodity or article, or thing bought and sold, of any class or kind whatsoever, including the price or premium to be paid for insuring property against loss or damage by fire, lightning or storm, and all arrangements, contracts, agreements, combinations or understandings made or entered into between any two or more persons which are designed

or made with a view to increase, or which tend to increase the market price of any product, commodity or article or thing, of any class or kind whatsoever bought and sold, including the price or premium to be paid for insuring property against loss or damage by fire, lightning or storm, are hereby declared to be against public policy, unlawful and void; and any person or persons creating, entering into, becoming a member of or participating in such arrangements, contracts, agreements, combinations or understandings shall be deemed and adjudged guilty of a conspiracy in restraint of trade, and punished as provided for in this act."

The remaining provisions of the statute relate to penalties against corporations and individuals, remedies and procedure. See *post*, § 446.

*Montana.* The anti-trust statute of this State (Penal Code, §§ 321-325) was declared by the Montana Supreme Court in 1905 to be unconstitutional (*State v. Cudahy Packing Co.*, 33 Mont. 179 (82 Pac. Rep. 833)),\* and no new statute has been enacted since. For consideration of the question of constitutionality, see *post*, § 421.

*Nebraska.* Cobbey's Comp. Stat. 1907, § 12028: "That every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce, within this State, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year or by both said punishments in the discretion of the court.

the common law. It made combinations in restraint of interstate commerce criminal and gave a right of action to persons

§ 12029: "That every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce, within this State, shall be guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court."

The remaining sections of the act relate to penalties against corporations and individuals, remedies and procedure. See *post*, §§ 446, 448.

Nebraska has also a statute (Laws 1907), to prevent unfair commercial discrimination between different localities.

The anti-trust act of 1897 was repealed by implication by the foregoing statute except as to the first section defining trusts. *State v. Omaha Elevator Co.* (Neb. 1906), 106 N. W. Rep. 979.

*New Hampshire.* Const. Art. 82: "Free and fair competition in the trades and industries is an inherent and essential right of the people and should be protected against all monopolies and conspiracies which tend to hinder or destroy it. The size and functions of all corporations should be so limited and regulated as to prohibit fictitious capitalization, and provision should be made for the supervision and government thereof:—Therefore, all just power possessed by the State is hereby granted to the general court to enact laws to prevent the operations within the State of all persons and associations, and all trusts and corporations, foreign and domestic, and the officers thereof, who endeavor to raise the price of any article of commerce or to destroy free

and fair competition in the trades and industries through combination, conspiracy, monopoly, or any other unfair means; to control and regulate the acts of all such persons, associations, corporations, trusts, and officials doing business within the State; to prevent fictitious capitalization; and to authorize civil and criminal proceedings in respect to all the wrongs herein declared against."

*New Mexico.* Comp. Laws (1897), § 1292: "Every contract or combination between individuals, associations or corporations, having for its object, or which shall operate, to restrict trade or commerce or control the quantity, price or exchange of any article of manufacture or product of the soil or mine, is hereby declared to be illegal. Every person, whether as individual or agent or officer or stockholder of any corporation or association, who shall make any such contract or engage in any such combination, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by a fine not exceeding one thousand dollars nor less than one hundred dollars, and by imprisonment at hard labor not exceeding one year, or until such fine has been paid.

§ 1293. "Every person who shall monopolize or attempt to monopolize, or combine or conspire with any other person or persons to monopolize, any part of the trade or commerce of this territory, shall be deemed guilty of a misdemeanor and on conviction thereof shall be punished by" fine and imprisonment.

The act further provides that all contracts in violation of its provisions shall be void and that purchasers of commodities from persons or corporations violating the act shall not be liable therefor.

injured thereby. The State anti-trust statutes followed the federal statute, but were even more drastic. The difficulty

*New York.* Birdseye's R. S. 1901, p. 2405 (Laws 1899, ch. 690), § 1: "Every contract, agreement, arrangement or combination, whereby a monopoly in the manufacture, production or sale in this State of any article or commodity of common use is or may be created, established or maintained, or whereby competition in this State in the supply or price of any such article or commodity is or may be restrained or prevented, or whereby, for the purpose of creating, establishing or maintaining a monopoly within this State of the manufacture, production or sale of any such article or commodity, the free pursuit in this State of any lawful business, trade or occupation, is or may be restricted or prevented, is hereby declared to be against public policy, illegal and void.

§ 2: "Every person or corporation, or any officer or agent thereof, who shall make or attempt to make or enter into any such contract, agreement, arrangement or combination, or who, within this State, shall do any act pursuant thereto, or in, toward or for the consummation thereof, wherever the same may have been made, is guilty of a misdemeanor, and on conviction thereof shall, if a natural person, be punished by a fine not exceeding five thousand dollars, or by imprisonment for not longer than one year, or by both such fine and imprisonment; and if a corporation, by a fine of not exceeding five thousand dollars.

§ 3: "The attorney-general may bring an action in the name and in behalf of the people of the State against any person, trustee, director, manager, or other officer or agent of a corporation, or against a corporation, foreign or domestic, to restrain and prevent the doing in this State of any

act herein declared to be illegal, or any act, in, toward or for the making or consummation of any contract, agreement, arrangement or combination herein prohibited wherever the same may have been made."

The remaining sections of the act relate to procedure in obtaining testimony.

Another New York statute (Laws 1897, ch. 384; Stock Corp. Law, § 7) is as follows: "No domestic stock corporation and no foreign corporation doing business in this State shall combine with any other corporation or person for the creation of a monopoly or the unlawful restraint of trade or for the prevention of competition in any necessary of life."

*North Carolina.* Const. Art. I. § 31: "Perpetuities and monopolies are contrary to the genius of a free State, and ought not to be allowed."

Laws 1899, ch. 666: "Any corporation organized under the laws of this or any other State or country for transacting or conducting any kind of business in this State, or any partnership or individual or other association of persons whatsoever, who shall create, enter into, become a member of, or a party to, any pool, trust, agreement, combination, confederation or understanding with any other corporation, partnership, individual or any other person or association of persons to regulate or fix the price of any article of merchandise or commodity, or shall enter into, become a member of, or a party to, any pool, agreement, contract, combination or confederation to fix the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold in this State, shall be deemed and adjudged guilty of a conspiracy to defraud and be subject to the penalties provided in this act."

with many of them, however, was that they went too far in some directions and not far enough in others. Their exemp-

For penalties against corporations and individuals, see *post*, §§ 446, 448.

The Act of March 11, 1907, "prohibiting conduct within the State of North Carolina, which interferes with trade and commerce" declares the following acts and things unlawful and imposes penalties:

a. Sales on condition that purchaser shall not deal in goods of competitors or trade rivals or sellers.

b. Destroying, injuring or attempting to destroy or injure opponent or business rival with intent to fix price where competition is removed.

c. Reduction of selling price or raising of buying price by seller of fifty per cent of any article with intent to profit by destroying competitors.

d. Sales at place where there is competition at less price than at another place, with intent to injure business of another.

e. Agreements or understandings not to buy or sell within certain territory with intent to prevent competition in buying or selling.

*North Dakota*. Const. Art. VII. § 146: "Any combination between individuals, corporations, associations, or either, having for its object or effect the controlling of the price of any product of the soil or any article of manufacture or commerce, or the cost of exchange or transportation, is prohibited and hereby declared unlawful and against public policy, and any and all franchises heretofore granted or extended, or that may hereafter be granted or extended in this State, whenever the owner or owners thereof violate this article shall be deemed annulled and become void."

Laws 1907, ch. 259, p. 413: "Any corporation organized under the laws of this State or any other State or

country for transacting or conducting any kind of business in this State, or any partnership, association or individual, creating, entering into or becoming a member of, or a party to, any pool, trust, agreement, contract, combination, confederation or individual, to regulate or fix the price of any article of merchandise, commodity or property, or to fix or limit the amount or quantity of any article, property, merchandise or commodity to be manufactured, mined, produced, exchanged or sold in this State, shall be guilty of a misdemeanor."

The act also defines pools and trusts; provides for the punishment of corporations and corporate officers; declares contracts in violation of its provisions void, and regulates procedure.

Laws 1907, ch. 258, p. 412: "Any person, firm or corporation, foreign or domestic, doing business in the State of North Dakota and engaged in the production, manufacture or distribution of any commodity in general use, that shall intentionally, for the purpose of destroying or preventing competition, discriminate between different sections, communities or cities of this State by selling any such commodity at a lower rate or price in one section, community or city, or any portion thereof, than is charged for such commodity in any other section, community or city, after equalizing the distance from the point of manufacture, production or distribution and freight rates therefrom, or who shall wilfully, for the purpose of such discrimination and unfair competition, refuse to sell any commodity in general use, and in the manufacture, production or distribution of which such person, firm or corporation may be engaged, to any

tions made them class legislation of the most obvious character, and they were declared unconstitutional by the courts

other person, firm or corporation which may desire to purchase the same and who shall comply with all reasonable regulations of such person, firm or corporation, and who shall tender payment thereof, shall be deemed guilty of a misdemeanor."

Another similar statute against discriminations is in Laws 1907, ch. 260, p. 418.

*Ohio.* Act of July 1, 1898, § 1: "A trust is a combination of capital, skill or acts by two or more persons, firms, partnerships, corporations or association of persons, or of any two or more of them for either, any or all of the following purposes:

1. To create or carry out restrictions in trade or commerce.

2. To limit or reduce the production, or increase, or reduce the price of merchandise or any commodity.

3. To prevent competition in manufacturing, making, transportation, sale or purchase of merchandise, produce or any commodity.

4. To fix at any standard or figure, whereby its price to the public or consumer shall be in any manner controlled or established, any article or commodity of merchandise, produce or commerce intended for sale, barter, use or consumption in this State.

5. To make or enter into or execute or carry out any contracts, obligations or agreements of any kind or description, by which they shall bind or have bound themselves not to sell, dispose of or transport any article or any commodity or any article of trade, use, merchandise, commerce or consumption below a common standard figure or fixed value, or by which they shall agree in any manner to keep the price of such article, commodity or transportation at a fixed or graduated figure, or by which they shall in any manner establish or settle the price

of an article, commodity or transportation between them or themselves and others, so as to directly or indirectly preclude a free and unrestricted competition among themselves, or any purchasers or consumers in the sale or transportation of any such article or commodity, or by which they shall agree to pool, combine or directly or indirectly unite any interests that they may have connected with the sale or transportation of any such article or commodity, that its price might in any manner be affected. Every such trust as is defined herein is declared to be unlawful, against public policy and void."

For penalties against corporations and individuals, see *post*, §§ 446, 448.

*Oklahoma.* Const. 1907, § 45, Art. IX. "Until otherwise provided by law, no person, firm, association or corporation engaged in the production, manufacture, distribution or sale of any commodity of general use, shall, for the purpose of creating a monopoly or destroying competition in trade, discriminate between different persons, associations or corporations, or different sections, communities or cities of the State, by selling such commodity at a lower rate in one section, community or city than in another, after making due allowance for the difference, if any, in the grade, quantity or quality, and in the actual cost of transportation from the point of production or manufacture."

Rev. Stat. ch. 83: (1) "If any individual, firm, partnership, or any association of persons whatsoever, shall create, enter into, become a member of, or a party to, any pool, trust, agreement, combination or understanding with any other individual, firm, partnership or association of persons whatsoever, to regulate

following the lead of the Supreme Court of the United States. The more recent statutes, however, have been passed in view

or fix the price of, or prevent or restrict the competition in the sale of, provisions, feed, fuel, lumber or other building materials, articles of merchandise or other commodity, [they] shall be deemed guilty of [a] misdemeanor, and upon conviction thereof shall be fined not less than fifty nor more than five hundred dollars.

(2) "It shall not be lawful for any corporation . . . to enter into any combination, contract, trust, pool or agreement with any other corporation or corporations, or with any individual, firm, partnership or association of persons whatsoever, for the purpose of regulating or fixing the price of, or preventing or restricting competition in the sale of provisions, feed, fuel, lumber or other building materials, articles of merchandise or other commodity, including the fixing of the rate of interest."

For provision that act may be pleaded as a defence, see *post*, § 445. For penalties against corporations, see *post*, §§ 446, 448.

*South Carolina.* Civ. Code 1902, § 2845: "All arrangements, contracts, agreements, trusts or combinations between two or more persons as individuals, firms or corporations, made with a view to lessen, or which tend to lessen, full and free competition in the importation or sale of articles imported into this State, or in the manufacture or sale of articles of domestic growth, or of domestic raw material, and all arrangements, contracts, agreements, trusts or combinations between persons or corporations, designed or which tend to advance, reduce or control the price or the cost to the producer or to the consumer of any such product or article, and all arrangements, contracts, trusts, syndicates, associations or combinations

between two or more persons as individuals, firms, corporations, syndicates or associations, that may lessen or affect in any manner the full and free competition in any tariffs, rates, tolls, premiums or prices, or seeks to control in any way or manner such tariffs, rates, tolls, premiums or prices in any branch of trade, business or commerce, are hereby declared to be against public policy, unlawful and void."

For penalties against corporations and individuals, see *post*, §§ 446, 448.

*South Dakota.* Const. Art. XVII. par. 20: "Monopolies and trusts shall never be allowed in this State, and no incorporated company, copartnership or association of persons in this State shall, directly or indirectly, combine or make any contract with any incorporated company, foreign or domestic, through their stockholders or the trustees or assigns of such stockholders, or with any copartnership or association of persons, or in any manner whatsoever to fix the prices, limit the production or regulate the transportation of any product or commodity so as to prevent competition in such prices, production or transportation, or to establish excessive prices therefor. The legislature shall pass laws for the enforcement of this section by adequate penalties, and, in the case of incorporated companies, if necessary for that purpose, may, as a penalty, declare the forfeiture of their franchises."

Penal Code, 1903, § 770: "Within the meaning of this act, a trust or a monopoly is a combination of capital, skill, or acts of two or more persons, firms, corporations or associations of persons, first, to create or carry out restrictions in trade; second, to limit the production or to increase or reduce the price of commodities; third,



of these decisions and avoid the constitutional objections attaching to the earlier enactments.

to prevent competition in the manufacture, transportation, sale or purchase of merchandise, produce or commodities; fourth, to fix any standard or figure whereby the price to the public shall be in any manner established or controlled.

§ 771: "That it shall be unlawful for any incorporated company, copartnership or association of persons in this State, directly or otherwise, to fix prices, limit the production or regulate the transportation of any product or commodity so as to obstruct or delay or prevent competition in such production or transportation or limit transportation of commodities or to fix prices therefor.

§ 772: "That it shall be unlawful for any incorporated company, copartnership or association of persons in another State to directly or otherwise combine or make any contract with any incorporated company, copartnership, association or person or persons in this State to combine or make any contract to fix prices, limit the production of commodity or regulate the transportation, directly or otherwise, of any product or commodity so as to obstruct or prevent competition or limit transportation or to fix prices therefor."

For penalties against corporations and individuals, see *post*, §§ 446, 448.

*Tennessee*. Const. Art. I. § 22: "That perpetuities and monopolies are contrary to the genius of a free State, and shall not be allowed."

Acts 1903, ch. 140, § 1: "From and after the passage of this act all arrangements, contracts, agreements, trusts or combinations between persons or corporations made with a view to lessen, or which tend to lessen full and free competition in the importation or sale of articles imported into this State, or in the manufacture or

sale of articles of domestic growth or of domestic raw material, and all arrangements, contracts, agreements, trusts or combinations between persons or corporations designed, or which tend to advance, reduce or control the price or the cost to the producer or the consumer of any such product or article, are hereby declared to be against public policy, unlawful and void."

§ 3: "Any violation of the provisions of this act shall be deemed, and is hereby declared to be destructive of full and free competition and a conspiracy against trade, and any person or persons who may engage in any such conspiracy or who shall, as principal, manager, director or agent, or in any other capacity, knowingly carry out any of the stipulations, purposes, prices, rates or orders made in furtherance of such conspiracy, shall, upon conviction, be punished by a fine of not less than one hundred dollars nor more than five thousand dollars, and by imprisonment in the penitentiary not less than one year nor more than ten years; or in the judgment of the court, by either such fine or imprisonment."

The remaining sections of the act provide for the forfeiture of the charters of domestic corporations and the ouster from the State of foreign corporations, violating its provisions, remedies and procedure. (See *post*, § 448.)

Acts 1907, ch. 36, p. 126: "That it shall be unlawful for any person, firm or corporation engaged in the business of manufacturing in this or any other State to give away, or sell for a less price than the cost of manufacture, any manufactured article in this State, with the intent and purpose of destroying honest competition."

These statutes, as a general rule, declare contracts and combinations in restraint of competition both criminal and unlaw-

*Texas.* Const. Art. I. § 26: "Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed."

Act of March 31, 1903, as amended in 1907, § 1: "That a trust is a combination of capital, skill or acts by two or more persons, firms, corporations or associations of persons, or either two or more of them for either, any or all of the following purposes:

1. To create or which may tend to create or carry out restrictions in trade or commerce or aids to commerce or in the preparation of any product for market or transportation, or to create or carry out restrictions in the free pursuit of any business authorized or permitted by the laws of this State.

2. To fix, maintain, increase or reduce the price of merchandise, produce or commodities, or the cost of insurance, or of the preparation of any product for market or transportation.

3. To prevent or lessen competition in the manufacture, making, transportation, sale or purchase of merchandise, produce or commodities, or the business of insurance, or to prevent or lessen competition in aids to commerce, or in the preparation of any product for market or transportation.

4. To fix or maintain any standard or figure whereby the price of any article or commodity of merchandise, produce or commerce, or the cost of transportation, or insurance, or the preparation of any product for market or transportation, shall be in any manner affected, controlled or established.

5. To make, enter into, maintain, execute or carry out any contract, obligation or agreement, by which

the parties thereto bind, or have bound themselves not to sell, dispose of, transport or to prepare for market or transportation any article or commodity, or to make any contract of insurance at a price below a common standard or figure, or by which they shall agree in any manner to keep the price of such article or commodity or charge for transportation or insurance, or the cost of the preparation of any product for market or transportation at a fixed or graded figure, or by which they shall in any manner affect or maintain the price of any commodity or article or the cost of transportation or insurance or the cost of the preparation of any product for market or transportation between them or themselves and others, to preclude a free and unrestricted competition among themselves or others in the sale or transportation of any such article or commodity or business of transportation or insurance or the preparation of any product for market or transportation, or by which they shall agree to pool, combine or unite any interest they may have in connection with the sale or purchase of any article or commodity or charge for transportation or insurance or charge for the preparation of any product for market or transportation whereby its price or such charge might be in any manner affected.

6. To regulate, fix or limit the output of any article or commodity which may be manufactured, mined, produced or sold, or the amount of insurance which may be undertaken, or the amount of work that may be done in the preparation of any product for market or transportation.

7. To abstain from engaging in or continuing business or from the purchase or sale of merchandise, produce or commodities partially or entirely

ful. They impose penalties of fine or imprisonment upon individuals, and provide for the forfeiture of the charters of domestic

within the State of Texas, or any portion thereof.

§ 2. That a monopoly is a combination or consolidation of two or more corporations when effected in either of the following methods:

1. When the direction of the affairs of two or more corporations is in any manner brought under the same management or control for the purpose of producing, or where such common management or control tends to create a trust as defined in the first section of this act.

2. Where any corporation acquires the shares or certificates of stock or bonds, franchise or other rights, or the physical properties, or any part thereof, of any other corporation or corporations, for the purpose of preventing or lessening, or where the effect of such acquisition tends to affect or lessen competition, whether such acquisition is accomplished directly or through the instrumentality of trustees or otherwise.

§ 3. That either or any of the following acts shall constitute a conspiracy in restraint of trade:

1. Where any two or more persons, firms, corporations or associations of persons who are engaged in buying or selling any article of merchandise, produce or any commodity, enter into an agreement or understanding to refuse to buy from or sell to any other person, firm, corporation or association of persons any article of merchandise, produce or commodity.

2. Where any two or more persons, firms, corporations or associations of persons shall agree to boycott or threaten to refuse to buy from or sell to any person, firm, corporation or association of persons for buying from or selling to any other person, firm, corporation or association of persons.

§ 4. Any and all trusts, monopolies and conspiracies in restraint of trade as herein defined, are hereby prohibited and declared to be illegal."

The remaining sections of the act relate to penalties against corporations and individuals and procedure. (See *post*, §§ 446, 448.)

*Utah*. Const. Art. XII. § 20: "Any combination, by individuals, corporations or associations, having for its object or effect the controlling of the price of any products of the soil, or of any article of manufacture or commerce, or the cost of exchange or transportation, is prohibited, and hereby declared unlawful, and against public policy. The legislature shall pass laws for the enforcement of this section by adequate penalties, and in case of incorporated companies, if necessary for that purpose, it may declare a forfeiture of their franchises."

Rev. Stat. 1898, § 1752, (1): "Any combination by persons having for its object or effect the controlling of the prices of any professional services, any products of the soil, any article of manufacture or commerce, or the cost of exchange or transportation, is prohibited and declared unlawful.

(2) "Any person or association of persons who shall create, enter into, become a member of, a party to any pool, trust, agreement, combination, confederation or understanding with any other person or persons to regulate or fix the price of any article of merchandise or commodity; or shall enter into, become a member of, or a party to, any pool, trust, agreement, contract, combination or confederation to fix or limit the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold in this State, shall be deemed and adjudged guilty of a conspiracy to defraud, and be

corporations, and the ouster from the State of foreign corporations, violating their provisions. They also usually afford persons injured by a combination a right of action for damages.

subject to punishment as hereinafter provided."

The statute also contains provisions against trust certificates and trusts.

For penalties against corporations and individuals, see *post*, §§ 446, 448.

*Washington.* Const. Art. XII. § 22: "Monopolies and trusts shall never be allowed in this State, and no incorporated company, copartnership or association of persons in this State shall, directly or indirectly, combine or make any contract with any other incorporated company, foreign or domestic, through their stockholders or the trustees or assignees of such stockholders, or with any copartnership or association of persons, or in any manner whatever, for the purpose of fixing the price or limiting the production or regulating the transportation of any product or commodity. The legislature shall pass laws for the enforcement of this section by adequate penalties, and, in case of incorporated companies, if necessary for that purpose, may declare a forfeiture of their franchise."

The Washington statute (Act of March 21, 1895) is confined to combinations of commission merchants.

*Wisconsin.* Stat. 1898, ch. 86, § 1791 *j*, as amended by laws 1905, ch. 507, § 7: "Any corporation organized under the laws of this State which shall enter into any combination, conspiracy, trust, pool, agreement or contract intended to restrain or prevent competition in the supply or price of any articles or commodity in general use in this State, or constituting a subject of trade or commerce therein, or which shall in any manner control the price of any such article or commodity, fix the price thereof, limit or fix the amount or quantity

thereof to be manufactured, mined, produced or sold in this State, or fix any standard or figure by which its price to the public shall be in any manner controlled or established, shall upon proof thereof, in any court of competent jurisdiction, have its charter or authority to do business in this State cancelled and annulled. Every such corporation shall upon filing its annual statement with the Secretary of State, make and attach thereto the affidavit of its president, secretary or general managing officer, fully stating the facts in regard to the matters specified in this section."

*Ib.* § 1770 *g*, as amended by laws 1905, ch. 506, § 2: "Any foreign corporation which shall enter into any combination, conspiracy, trust, pool, agreement or contract intended to restrain or prevent competition in the supply or price of any article or commodity in general use in the State, or constituting a subject of trade or commerce therein, or which shall in any manner control the price of any such article or commodity, fix the price thereof, limit or fix the amount or quantity thereof to be manufactured, mined, produced or sold in this State, or fix any standard or figure by which its price to the public shall be in any manner controlled or established, shall, upon proof thereof, in any court of competent jurisdiction, have its license or authority to do business in this State cancelled and annulled."

Domestic corporations violating these statutes forfeit their charters and foreign corporations may be ousted from the State. (See *post*, § 448.)

*Wyoming.* Const. Art. I. § 30: "Perpetuities and monopolies are contrary to the genius of a free State and shall not be allowed. Corporations,

In so far as combinations result from the operation of economic principles, it may well be doubted whether they can be prevented by legislation. As we have noticed, the extreme development of the idea of combination has taken place with stringent statutes against combinations upon the statute books. Still, many of the evils of combinations — especially those possessing the element of oppression — may undoubtedly be reached by the present State enactments if within their sphere.

§ 415. **Sphere of State Legislation. Operation of Commerce Clause of the Constitution.** — The commerce clause of the federal Constitution<sup>1</sup> confers upon Congress the power to regulate interstate commerce. This power is broad and comprehensive. Under it Congress has enacted the federal anti-trust statute which prohibits all combinations in restraint of commerce among the States. Its purpose is to permit such commerce to flow in its natural channels unrestrained by any combination whatsoever. The power of Congress and the legislation thereunder are as exclusive as they are comprehensive. The States are wholly without power to legislate concerning combinations in restraint of interstate commerce.

The sphere of State legislation concerning combinations, as compared with that of federal legislation, is limited. The business of the great producing combinations, outside the States in which their plants are located, is carried on by means of interstate commerce. Shipments beginning and ending within the limits of a single State are inconsiderable when measured against the vast volume of interstate shipments. The effective regulation of combinations of railroad companies and of the great industrial corporations cannot result from State legislation. State anti-trust statutes can only reach combinations doing a localized business. Their field of operation, although most important, is not broad.<sup>2</sup>

being creatures of the State, endowed for the public good with a portion of its sovereign powers, must be subject to its control."

*Ib.* Art. X. § 8: "There shall be no consolidation or combination of corporations of any kind whatever to prevent competition, to control or

influence productions or prices thereof, or in any manner to interfere with the public good and general welfare."

<sup>1</sup> The commerce clause is printed in note to § 379, *ante*.

<sup>2</sup> As pointed out in the consideration of the federal statute (see *ante*, § 393), the later decisions of the

**§ 416. Controlling Propositions in determining Constitutionality of State Statutes.** — With the underlying principle established that the sphere of State anti-trust legislation is intrastate

Supreme Court of the United States seem to indicate that the application of the *Knight* decision (United States v. E. C. Knight Co., 156 U. S. 12 (1895), 15 Sup. Ct. Rep. 249), will not be extended. If, however, it should be broadly held that the principles of that decision render the federal statute inapplicable to all producing combinations which merely manufacture and deliver their products to common carriers, and do not attempt to directly control disposition, then the great industrial corporations of the country have practically no concern with anti-trust statutes — State or federal — unless perchance they exist in the States where their plants are located or in which they obtain their charters. Under such a construction of the federal statute the commerce clause of the Constitution would not only fail as a source of federal power, but would *interfere with* State legislation.

This result would follow from the operation of elementary principles. A corporation created by the laws of one State has no absolute right to transact a localized business in another. Its privileges in other States are permissive and depend upon comity. A State may exclude foreign corporations entirely. It may admit some and exclude others. It may impose such conditions — reasonable or unreasonable — upon those it admits as it may deem expedient. State anti-trust acts apply to foreign as well as to domestic corporations in so far as they have plants or property within the State or are transacting a business not of an interstate character. (See *post*, § 436.) But foreign corporations engaged in interstate commerce cannot be interfered with by State legislation. Under the commerce

clause, the Supreme Court has repeatedly held that State laws imposing conditions upon the sale of goods to be shipped into a State are unconstitutional as intrenching upon the powers of Congress. The sale by a foreign corporation, by sample or otherwise, of goods outside the State and their subsequent shipment across State lines is interstate commerce with which alone Congress has power to deal. The consequence is, as pointed out in the text, that State anti-trust statutes apply only to corporate combinations doing a localized business, *e.g.* insurance companies and corporations having local distributing centres. And any regulation of the domestic corporate combination must prove ineffective if its competitor may locate over the boundary line and freely ship goods into the State and sell them below cost for the purpose of stifling local competition. How far the State anti-discrimination statutes (see *ante*, § 414, *note*) will meet the latter practice remains to be seen.

Manifestly no remedy for this condition, should it arise, can be found in State legislation. State statutes cannot affect interstate commerce, and that which requires regulation is interstate commerce. Moreover, whatever deficiencies may exist in the present federal statute, it cannot be broadened by amendment. It already prohibits all combinations in restraint of interstate commerce. Neither its terms nor its application can be extended. It reaches the constitutional limit in the regulation of interstate commerce through the removal of restraint. But the regulation of commerce may consist in the *imposition* as well as in the removal of restraint. If the present statute prove insufficient, it may be necessary

commerce, the further examination of the subject of the constitutionality of such legislation will proceed along the lines of the following broad and controlling propositions:

(1) *Quasi*-public corporations, in their relations with other corporations, are subject to the control of the State.

(2) Property devoted to public use is subject to public regulation.

(3) Under its reserved power, the State has greater power over a corporation than over an individual.

(4) The right to contract is a natural, but not an absolute, right.

(5) The police power of the State may be exercised for the promotion of the public welfare — not solely for the protection of the public health, morals and safety.

(6) The exemption of classes of persons and products from the operation of State anti-trust laws is in violation of the Fourteenth Amendment to the federal Constitution.

(7) Statutes which stand the test of the Fourteenth Amendment will stand the test of any State constitutional provision protecting property rights, but must conform to other State provisions.

§ 417. **Power of State to prohibit Combinations of Quasi-public Corporations. Power over Property devoted to Public Uses.** — *Quasi*-public corporations, in consideration of the grant of public franchises, assume the performance of public duties. Contracts with other corporations interfering, in any degree, with the proper discharge of their obligations, are against public policy.

The State may make regulations for the control and management of *quasi*-public corporations.<sup>1</sup> It may, by statute, provide penalties for the execution of agreements inimical to public policy, and may control the relations between such corporations. State laws, designed for the promotion of the public interests, prohibiting combinations of *quasi*-public corporations, are, unquestionably, constitutional.

to place limitations upon interstate commerce. And the first step in such direction might properly be to supplement State legislation with respect to foreign corporate combinations

operating in States by means of interstate commerce.

<sup>1</sup> See *Georgia, etc. Banking Co. v. Smith*, 128 U. S. 174 (1888), (9 Sup. Ct. Rep. 47), as an illustrative case.

But the power of the State is broader than its right to regulate *quasi*-public corporations. It is not dependent upon what may be termed the contractual obligations of those corporations — assumed in consideration of public grants, — but may grow out of the nature of the business of any corporation — *quasi*-public or private — or individual. Whenever the nature of a business implies a public duty, the State has power to see that the duty is performed. In the leading case of *Munn v. Illinois*,<sup>1</sup> the Supreme Court of the United States, in declaring constitutional a law regulating charges at grain elevators, said: "Property does become clothed with a public interest when used in a manner to make it of public consequence and affect the community at large. When, therefore, one devotes his property to a use in which the public have an interest, he, in effect, grants to the public an interest in that use and must submit to be controlled by the public for the common good to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use, but so long as he maintains the use, he must submit to the control."

This power of the State to exercise control over property devoted to a public use is analogous to its police power, but may be more precisely defined as its power, as trustee for the public, to enforce trusts attaching to property or business for the public benefit.

<sup>1</sup> *Munn v. Illinois*, 94 U. S. 113 (1876). Mr. Chief Justice Waite, in his opinion, said (p. 125): "This brings us to inquire as to the principles upon which this power of regulation rests, in order that we may determine what is within and what is without its operative effect. Looking then to the common law from whence came the right which the Constitution protects, we find that when private property is 'affected with a public interest it ceases to be *juris privati* only.' . . . Property does become clothed with a public interest when used in a manner to make it of public consequence and affect the community at large. When, therefore, one devotes

his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but so long as he maintains the use, he must submit to the control . . . (p. 130). But we need not go further. Enough has already been said to show that, when property is donated to a public use, it is subject to public regulation."

This doctrine was reaffirmed by the Supreme Court in *Budd v. New York*, 143 U. S. 517 (1892), (12 Sup. Ct. Rep. 468).



The question is entitled to serious consideration whether the exercise of this power may not afford an effective remedy for some of the evils of the combination. When a corporate combination obtains substantial control of the market for a necessary of life, its business — much more than that of a company operating a grain elevator — is “clothed with a public interest.” Its property is “used in a manner to make it of public consequence and affects the community at large.” Upon the principles of *Munn v. Illinois*, it would seem that the State might regulate the charges of such combinations — within reasonable limits — and exercise supervisory control over their management.<sup>1</sup>

The corporate combination, when of controlling power, might well be subjected to the rules governing *quasi*-public corporations. Its efficiency lies in its corporate character. In consideration of the grant of powers, why should it not assume the same obligations to the public in their exercise that the *quasi*-public corporation assumes in consideration of the grant of franchises?

§ 418. **Power of State to prohibit Combinations of Corporations in Exercise of Reserved Power.** — Corporations are the creations of the State, endowed with such faculties as it bestows and subject to such conditions as it imposes. Where power is reserved to modify their charters, the reservation is a part of the

<sup>1</sup> The language of an old English case is singularly applicable. In *Aldnutt v. Inglis*, 12 East 527 (1810), it appeared that the London Dock Co. had acquired virtual control of the warehouses for the reception of wines from importers, and the question was whether it could charge arbitrary rates for storage or was obliged to accept reasonable compensation. Lord Ellenborough said (p. 547): “There is no doubt that the general principle is favored, both in law and justice, that every man may fix what prices he pleases upon his own property or the use of it; but if, for a particular purpose, the public have a right to resort to his premises and make use

of them, and he have a monopoly in them for that purpose, if he will take the benefit of that monopoly, he must, as an equivalent, perform the duty attached to it on reasonable terms . . . (p. 539). It is enough that there exists in the place and for the commodity in question, a virtual monopoly of the warehousing for this purpose on which the principles of law attach as laid down by Lord Hale in the passage referred to [When private property is ‘affected with a public interest it ceases to be *juris privati* only.’ ‘*De Portibus Maris*,’ 1 Harg. Law Tracts, 78] which includes the good sense as well as the law of the subject.”

contract between the corporation and the State, and a legitimate exercise of the power in no way impairs the obligation of the contract.<sup>1</sup>

The power of the State, under its reservation, to regulate the contracts of corporations, and to control their relations with other corporations, is greater than its power over individuals. An act may be unconstitutional as to natural persons and constitutional as to corporations.<sup>2</sup>

It may be conceded that the legislature, under its right to amend, cannot take away from corporations the right to contract, or affect vested rights. But the State may, by laws having a prospective application, regulate the right to contract, and may prohibit combinations when prejudicial to the public interest. The determination of the question, what combinations are prejudicial, is within the province of the legislature, and only in the case of gross perversion of power could the courts intervene.<sup>3</sup>

§ 419. **Validity of State Statutes tested by Fourteenth Amendment — (A) Right to Contract.** — The test of the constitution-

<sup>1</sup> *St. Louis, etc. R. Co. v. Paul*, 173 U. S. 408 (1898), (19 Sup. Ct. Rep. 419).

In *Shaffer v. Union Mining Co.*, 55 Md. 74 (1880), the Supreme Court of Maryland said: "The acceptance by the corporation of a charter, with the reservation of the right to alter and amend, made that provision a part of the contract, which, as between the legislature and it as a private corporation, it must be understood to be. A corporation has no inherent or natural rights, like a citizen. It has no rights but those which are expressly conferred upon it, or are necessarily inferable from the powers actually granted, or such as may be indispensable to the exercise of such as may be granted. A private corporation is only a *quasi*-individual, the pure creation of the legislative will, with just such powers as are conferred expressly or by necessary limitation, and no others."

*Compare* *Braceville Coal Co. v. People*, 147 Ill. 66 (1893), (35 N. E. Rep. 62, 37 Am. St. Rep. 206, 22 L. R. A. 340).

<sup>2</sup> In *Leep v. St. Louis, etc. R. Co.*, 58 Ark. 407 (1894), (25 S. W. Rep. 75, 23 L. R. A. 264), an act was held unconstitutional as affecting natural persons, but constitutional as to corporations, as an exercise of a reserved power "to alter, revoke and annul any charter of incorporation."

The Court conceded that the legislature, under its reserved power, could not take from corporations the right to contract, but held that it could regulate that right when demanded by the public interest, although not to such an extent as to render the corporation unable to fulfil the purposes of its organization.

<sup>3</sup> See *United States v. Joint Traffic Ass'n*, 171 U. S. 566 (1898), (19 Sup. Ct. Rep. 25).

ality of any State anti-trust statute may properly be the Fourteenth Amendment to the Constitution of the United States. It broadly guarantees the right of property. A statute against combinations which does not contravene its provisions does not conflict with any provision of any State constitution protecting property rights.<sup>1</sup>

The Fourteenth Amendment provides that "no State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty or property, without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws."

The right of property secured by the Amendment necessarily includes the right to contract, for it is only by the exercise of that right that a person can lawfully acquire property by his own exertion. The right to contract cannot be taken away without "due process of law."<sup>2</sup>

<sup>1</sup> But State anti-trust statutes may contain provisions in conflict with other sections of State constitutions. See *post*, § 422: "*Validity of State Statutes under State Constitutional provisions.*"

<sup>2</sup> *Leep v. St. Louis, etc. R. Co.*, 58 Ark. 407 (1894), (25 S. W. Rep. 75, 23 L. R. A. 264).

*Ritchie v. People*, 155 Ill. 98 (1895), (40 N. E. Rep. 454, 46 Am. St. Rep. 315, 29 L. R. A. 79): "This right to contract which is thus included in the fundamental rights of liberty and property cannot be taken away without 'due process of law.'"

*Commonwealth v. Perry*, 155 Mass. 117 (1891), (28 N. E. Rep. 1126, 31 Am. St. Rep. 533, 14 L. R. A. 325): "The right to acquire, possess and protect property includes the right to make reasonable contracts, which shall be under the protection of the law."

*In re Grice*, 79 Fed. 627 (1897): "One of the most sacred rights of liberty is the right to contract. All of the rights of contract which are necessary

for the carrying on of ordinary business affairs are protected by the Constitution and are not capable of being restrained by legislative action."

"The third absolute right, inherent in every Englishman, is that of property, which consists in the free use, enjoyment and disposal of all his acquisitions, without any control or diminution, save only by the laws of the land." 1 Black. Com. 138.

*State v. Smiley*, 65 Kan. 240, 243 (1902), (69 Pac. Rep. 199, 67 L. R. A. 903), *affirmed* 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289): "The above statute is assailed with great vehemence by counsel for appellant. Their contention is that it imposes such limitations upon freedom of contract as to constitute a deprivation of the right of property, contrary to the guaranty of the Fourteenth Amendment to the federal Constitution. They say that, instead of being what it purports, an act to prevent unreasonable restrictions upon trade, it is itself such restriction, and is therefore violative of the fundamental

The right to contract, however, is not an absolute right, but may be subjected to restraints demanded by the welfare of the State.<sup>1</sup> The Fourteenth Amendment does not conflict with the exercise of the State's police power.<sup>2</sup> As said by Mr. Justice Field in *Barbier v. Connolly*:<sup>3</sup> "Neither the amendment — broad and comprehensive as it is — nor any other amendment was designed to interfere with the power of the State, sometimes called its police power, to prescribe regulations to promote the health, peace, morals, education and good order of the people, and to legislate so as to increase the industries of the State, develop its resources and add to its wealth and prosperity."

The question, therefore, whether a State statute regulating the right to combine<sup>4</sup> — a form of the right to contract —

right to acquire property by lawful contract."

See also *State v. Associated Press*, 159 Mo. 410 (1900), (60 S. W. Rep. 91, 51 L. R. A. 151).

<sup>1</sup> In *Frisbie v. United States*, 157 U. S. 165 (1895), (15 Sup. Ct. Rep. 586), Mr. Justice Brewer said: "While it may be conceded that, generally speaking, among the inalienable rights of the citizen is that of the liberty of contract, yet such liberty is not absolute and universal. It is within the undoubted power of government to restrain some individuals from all contracts, as well as all individuals from some contracts. It may deny to all the right to contract for the purchase or sale of lottery tickets; to the minor, the right to assume any obligations, except for the necessities of existence; to the common carrier, the power to make any contract releasing himself from negligence, and, indeed, may restrain all engaged in any employment from any contract in the course of that employment which is against public policy."

See also *Knoxville Iron Co. v. Harbison*, 183 U. S. 20 (1901); *St. Louis, etc. R. Co. v. Paul*, 173 U. S. 408 (1898), (19 Sup. Ct. Rep. 419); *Orient Ins. Co. v. Daggs*, 172 U. S. 565 (1898),

(19 Sup. Ct. Rep. 281); *Hooper v. California*, 155 U. S. 658 (1895), (15 Sup. Ct. Rep. 207); *Leep v. St. Louis, etc. R. Co.*, 58 Ark. 407 (1894), (25 S. W. Rep. 75).

<sup>2</sup> *Davis v. Massachusetts*, 167 U. S. 43 (1897), (17 Sup. Ct. Rep. 731); *Jones v. Brim*, 165 U. S. 180 (1897), (17 Sup. Ct. Rep. 282); *Covington, etc. Turnpike Co. v. Sandford*, 164 U. S. 592 (1896), (17 Sup. Ct. Rep. 198); *Giozza v. Tiernan*, 148 U. S. 657 (1893), (13 Sup. Ct. Rep. 721); *Mugler v. Kansas*, 123 U. S. 623 (1887), (8 Sup. Ct. Rep. 273); *Barbier v. Connolly*, 113 U. S. 27 (1885), (5 Sup. Ct. Rep. 357).

<sup>3</sup> *Barbier v. Connolly*, 113 U. S. 31 (1885), (5 Sup. Ct. Rep. 357).

<sup>4</sup> "A man has a constitutional right to buy anything, or any quantity, provided he use only fair means, and set his own price on it, or refuse to sell it at all. And what one man may do as an individual, two or more may do when combined as partners. Combination for business purposes is legal. Combinations are beneficial as well as injurious, according to the motives or aims with which they are formed. It is therefore impossible to prohibit all combinations. The prohibition must rest upon the objectionable character

contravenes the provisions of the Fourteenth Amendment guaranteeing the right of property, depends upon whether it was enacted in the legitimate exercise of the police power of the State.

§ 420. **Validity of State Statutes tested by Fourteenth Amendment — (B) Police Power of the State.** — The police power of the State may be broadly defined as that inherent and plenary power which enables it to interdict that which is prejudicial to the welfare of society. It has been aptly termed "the law of overruling necessity."<sup>1</sup>

of the objects of the combination." Tiedeman Lim. Police Power, 244.

But compare this language with the decision in *Bailey v. Master Plumbers' Ass'n*, 103 Tenn. 99 (1899), (52 S. W. Rep. 853, 46 L. R. A. 561), where it was held that the legal right of an individual plumber to purchase supplies from any dealer he pleases will not justify a by-law of an association of plumbers which permits members to make purchases only from such dealers as will sell to members exclusively, *the individual right being radically different from the combined action*.

It is clear that persons cannot always combine to do that which individually they may have the right to do. The act of combining in itself may be against public policy or be prohibited by statute.

<sup>1</sup> *Town of Lakeview v. Rose Hill Cemetery Co.*, 70 Ill. 191 (1873), (22 Am. Rep. 71).

The police power of the State extends not only over matters relating to the health, morals and safety of the public, but over whatever relates to the public comfort and convenience. *Lake Shore, etc. R. Co. v. Ohio*, 173 U. S. 285 (1899), (19 Sup. Ct. Rep. 465).

"The police of a State, in a comprehensive sense, embraces its whole system of internal regulation by which the State seeks not only to preserve

the public order and to prevent offences against the State, but also to establish, for the intercourse of citizens with citizens, those rules of good manners and good neighborhood which are calculated to prevent a conflict of rights, and to insure to each the uninterrupted enjoyment of his own so far as reasonably consistent with a like enjoyment of rights by others." Cooley's Const. Lim. (4th ed.) 713.

*Thorpe v. Rutland, etc. R. Co.*, 27 Vt. 149 (1855), (62 Am. Dec. 625) (Redfield, C. J.): "The police power of the State extends to the protection of the lives, limbs, health, comfort and quiet of all persons, and the protection of all property within the State."

*Commonwealth v. Alger*, 7 Cush. (Mass.) 84 (1851), (Shaw, C. J.): "The power we allude to is rather the police power; the power vested in the legislature by the Constitution to make, ordain and establish all manner of wholesome and reasonable laws, statutes and ordinances, either with penalties or without, not repugnant to the Constitution as they shall judge to be for the good and welfare of the Commonwealth and of the subjects of the same."

*New Orleans Gas Light Co. v. Hart*, 40 La. Ann. 474 (1888), (4 So. Rep. 215, 8 Am. St. Rep. 544): "Police power is the right of the State func-

The State, in the exercise of its police power, may enact "all such laws not in plain conflict with some provision of the State or federal Constitutions as may rightfully be deemed necessary or expedient for the safety, health, morals, comfort and welfare of the people."<sup>1</sup>

Laws against combinations for the purpose of restricting production, maintaining prices or suppressing competition, have a relation to the end of all police regulations — the comfort, welfare or safety of society.<sup>2</sup> The preservation of competition is clearly within the police power of the State.

tionaries to prescribe regulations for the good order, peace, protection, comfort and convenience of the community which do not encroach on the like power vested in Congress by the federal Constitution."

Mayor, etc. of New York *v. Miln*, 11 Pet. (U. S.) 139 (1837): "Every law comes within this description [a police regulation] which concerns the welfare of the whole people of the State, or any individual within it, whether it relates to their rights or their duties; whether it respects them as men or citizens of the State, whether in their public or private relations; whether it relates to the rights of persons or of property of the whole people of the State, or of any individual within it; and whose operation is within the territorial limits of the State, and upon the persons and things within its jurisdiction."

<sup>1</sup> In *Knoxville Iron Co. v. Harbison*, 183 U. S. 20 (1901), the Supreme Court of the United States quotes with approval the extract in the text from the decision of the Supreme Court of Tennessee in the same case, *sub nom. Harbison v. Knoxville Iron Co.*, 103 Tenn. 421 (1900), (53 S. W. Rep. 955).

*Lochner v. New York*, 198 U. S. 53 (1905), (25 Sup. Ct. Rep. 539): "These powers, broadly stated, and without any attempt at a more specific limitation, relate to the safety,

health, morals and general welfare of the public."

*Commonwealth v. Strauss*, 191 Mass. 550 (1906), (78 N. E. Rep. 136): "There is no doubt that the statute before us puts a limitation upon the general right to make contracts. The contention of the Commonwealth is that this limitation is valid as an exercise of the police power. The nature of the police power and its extent, as applied to conceivable cases, cannot easily be stated with exactness. It includes the right to legislate in the interest of the public health, the public safety and the public morals. If the power is to be held within the limits of the field thus defined, the words should be interpreted broadly and liberally. If we are to include in the definition, as many judges have done, the right to legislate for the public welfare, this term should be defined with some strictness, so as not to include everything that may be enacted on grounds of mere expediency."

<sup>2</sup> *Ritchie v. People*, 155 Ill. 98 (1895), (40 N. E. Rep. 454, 46 Am. St. Rep. 315, 29 L. R. A. 79): "The police power of the State is that power which enables it to promote the health, comfort, safety and welfare of society. It is very broad and far-reaching, but it is not without its limitations. Legislative acts passed in pursuance of it must not be in conflict

In the absence of statutory provisions, the law leaves combinations inimical to public policy as it finds them, and contents itself with declining to recognize or enforce their agreements. Statutes reënforcing the common law, defining the rules of public policy and making criminal combinations contrary thereto are, undoubtedly, valid.

The power of police, however, is not confined to providing additional penalties for entering into combinations previously unlawful. Statutes having for their object the preservation of competition and prohibiting all agreements or combinations, directly restraining or tending to directly restrain it in any degree, are undoubtedly constitutional, although they go much further than the common law.<sup>1</sup> The wisdom or policy of their

with the Constitution, and must have some relation to the ends sought to be accomplished, — that is to say, to the comfort, welfare or safety of society.”

It is within the police power of the legislature to determine what monopolies are contrary to the general welfare.

*In re* Opinion of the Justices, 193 Mass. 605 (1907), (81 N. E. Rep. 142).

*State v. Missouri, etc. R. Co.* (Tex. 1906), 91 S. W. Rep. 214, 219: “But it is said that this interpretation of the statute would render it unconstitutional, as impairing the obligation of a valid contract. . . . The same power which may, upon sufficient occasion, destroy other property of the citizen to secure the general welfare, may, to the same end, destroy the binding obligation of contracts. The constitutional inhibition against the impairment of the obligation of contracts is not a limitation upon the police power when exercised within its legitimate sphere, and therefore the mere objection that an exercise of that power impairs the obligation of a contract does not reach the true question, which is whether or not the attempted exercise is within the scope of the power exercised.”

<sup>1</sup> At the time of the first edition

of this treatise the broad question whether the State anti-trust statutes take away the property rights guaranteed by the Fourteenth Amendment had not been passed upon by the Supreme Court of the United States. But since then the Kansas and Texas statutes have been before the Court; their constitutionality has been questioned upon broad grounds, and they have been declared to be constitutional.

*Smiley v. Kansas*, 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289); *Jack v. Kansas*, 199 U. S. 372 (1905), (26 Sup. Ct. Rep. 73); *National Cotton Oil Co. v. Texas*, 197 U. S. 115 (1905), (25 Sup. Ct. Rep. 379).

In the *Smiley* case the Court said (p. 456): “Undoubtedly there is a certain freedom of contract which cannot be destroyed by legislative enactment. In pursuance of that freedom, parties may seek to further their business interests, and it may not always be easy to draw the line between those contracts which are beyond the reach of the police power and those which are subject to prohibition or restraint. But a secret arrangement, by which, under penalties, an apparently existing competition among all the dealers in a com-

munity in one of the necessities of life is substantially destroyed, without any merging of interests through partnership or incorporation, is one to which the police power extends."

In the *Texas* case the Court said (p. 129): "It is certainly the conception of a large body of public opinion that the control of prices through combinations tends to restraint of trade and to monopoly, and is evil. The foundations of the belief we are not called upon to discuss, nor does our purpose require us to distinguish between the kinds of combinations or the degrees of monopoly. It is enough to say that the idea of monopoly is not now confined to a grant of privileges. It is understood to include 'conditions produced by the acts of mere individuals.' Its dominant thought now is, to quote another, 'the notion of exclusiveness or unity'; in other words, the suppression of competition by the unification of interests or management, or it may be through agreement and concert of action. And the purpose is so definitely the control of prices that monopoly has been defined to be 'unified tactics with regard to prices.' It is the power to control prices which makes the inducement of combinations and their profit. It is such power that makes it the concern of the law to prohibit or limit them. And this concern and the policy based upon it has not only expression in the Texas statutes; it has expression in the statutes of other States and is a well-known national enactment. According to them, competition, not combination, should be the law of trade. If there is evil in this, it is accepted as less than that which may result from the unification of interest, and the power such unification gives. And that legislatures may so ordain, this Court has decided. . . . It follows that the statutes of Texas do not deprive the oil company of its property without due process of law."

The following decisions of State courts sustain the constitutionality of the anti-trust statutes of their respective States:

*Kansas.* The anti-trust statute of this State does not conflict with the guaranty of the right to acquire property by lawful contract secured by the federal Constitution and is a valid exercise of legislative power.

*State v. Smiley*, 65 Kan. 240 (1902), (69 Pac. Rep. 199), *affirmed* 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289).

*State v. Jack*, 69 Kan. 387 (1904), (76 Pac. Rep. 917), *affirmed* 199 U. S. 372 (1905), (26 Sup. Ct. Rep. 73): "The anti-trust law is a valid exercise of legislative power, and is not, as claimed by appellant, violative of the Fourteenth Amendment of the federal constitution."

*Michigan.* The statute of this State, declaring void all contracts designed in any manner to prevent or restrict free competition with respect to agricultural commodities, is constitutional. *Bingham v. Brands*, 119 Mich. 255 (1899), (77 N. W. Rep. 940).

The Michigan anti-trust statute of 1899, providing for the revocation of the certificate of any foreign corporation violating its provisions, is not in conflict with the clause of the Fourteenth Amendment providing that no State shall enforce any law which shall abridge the privileges or immunities of citizens of the United States.

*Attorney-General v. A. Booth & Co.*, 143 Mich. 89 (1905), (106 N. W. Rep. 868).

*Missouri.* *State v. Firemen's Fund Ins. Co.*, 152 Mo. 46 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363): "There is no such thing in civilized society as unrestrained power to contract. Every man surrenders some of his individual rights when he associates with or becomes a part of any society or government, and the power of the government to legislate is complete, so that while according to every man



the fullest possible liberty to do what he pleases with his own, he must not interfere with the similar right of others. This principle underlies and runs through all government and societies, and it is the corner-stone of the police power of the State."

*Ohio.* *State v. Buckeye Pipe Line Co.*, 61 Ohio State St. 547 (1900), (56 N. E. Rep. 464, 78 Am. St. Rep. 743): "The definite proposition of counsel upon this point is that although the act is an exercise of legislative power, it transcends the provisions of the State and federal constitutions which render inviolable the rights of liberty and property, which include the right to make contracts. It would be difficult to place too high an estimate upon these guaranties, and include the right to make contracts. But it is settled that these guaranties are themselves limited by the public welfare or the exercise of the police power. Although that power may not be conclusively defined, its nature and attributes have been the subject of much investigation. In all considerate discussions of the subject it is conceded that, in the exercise of this power, the legislature can prohibit only those uses of property which are hurtful to the public, and the inhibited use must be hurtful in a legal sense. That contracts like these are hurtful in that sense has been held in more cases than it would be practicable to cite."

*South Carolina.* The anti-trust statute of this State (Civil Code, 1902, § 2845) is a legitimate exercise of the police power of the State and is not in violation of the Fourteenth Amendment to the federal Constitution.

*State v. Virginia-Carolina Chemical Co.*, 71 S. C. 544 (1905), (51 S. E. Rep. 455).

*Tennessee.* *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 1039, 78 Am. St. Rep. 941): "The right of contract is confessedly an inherent part of both the right of

'liberty,' and the right of 'property,' and deprivation of it is therefore equally forbidden by that provision, but none of them are unrestricted rights. All are subject to the law's control, and may be abridged or even destroyed within constitutional bounds."

The statute sustained in this case was the Tennessee act of 1897, which was also declared to be constitutional in *Bailey v. Master Plumbers' Ass'n*, 103 Tenn. 99 (1899), (52 S. W. Rep. 853, 46 L. R. A. 561). This statute, however, contained a provision exempting from its provisions agricultural products and live stock, and was undoubtedly unconstitutional for that reason. The Tennessee anti-trust act of 1903 omitted this exemption and was held to be valid and constitutional in *State v. Witherspoon*, 115 Tenn. 138 (1906), (90 S. W. Rep. 852).

*Texas.* *Waters-Pierce Co. v. State*, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 940): "By adequate laws, looking to the suppression of evil, the State, through the exercise of its police power, must necessarily restrain the unbridled license of the citizen in his conduct and use of property, and restraints in this way have never been held to illegally impair his liberty. . . . The objection to the statutes, that they deprive the owner of his property without due process of law, is equally untenable. It was not the design of the Fourteenth Amendment of the Constitution of the United States to interfere with a just and proper exercise of the police power by the States. . . . If legislative authority exists to restrain the conduct of owners in a particular way in the use of property, deemed injurious to the public welfare, and the legislature having acted in the manner required, in passing laws, due process of law exists, in so far as it is necessary to find legal authority for prohibiting the act. Legal restraint imposed

provisions is a matter for legislative determination.<sup>1</sup> But any statute which, under the guise of preserving competition, takes away the right to contract entirely, or prohibits acts or agreements which can have no direct effect upon competition, is undoubtedly unconstitutional.<sup>2</sup>

Applying these principles to the existing State legislation against combinations, it may be broadly stated — without analyzing the statutes — that such legislation has been enacted in the legitimate exercise of the police power of the State and does not unduly infringe upon the rights of property, including the right to contract, guaranteed by the Fourteenth Amend-

upon the use of property does not deprive the owner of it without due process of law."

In *State v. Missouri, etc. R. Co.* (Tex. 1906), 91 S. W. Rep. 214, it was held that the Texas act of 1903 making trusts unlawful and applying to combinations formed prior to its enactment but carrying on business afterwards was not unconstitutional as impairing the obligation of contracts.

See also *Houck v. Anheuser-Busch Brewing Ass'n*, 88 Tex. 184 (1894), (30 S. W. Rep. 869); *Texas Brewing Co. v. Anderson* (Tex. Civ. App. 1897), 40 S. W. Rep. 737; *Texas Brewing Co. v. Durram* (Tex. 1898), 46 S. W. Rep. 880.

<sup>1</sup> *Waters-Pierce Co. v. State*, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 940): "When it is once admitted that a matter is a subject of police supervision, the expediency and wisdom of the means resorted to are subjects solely confided to the legislative department of the State, subject, however, to limitations imposed by the organic law of the nation."

<sup>2</sup> In *In re Grice*, 79 Fed. 627 (1897), Judge Swayne held the Texas anti-trust act unconstitutional upon the ground, among others, that it abridged the liberty of contract. The judge said, in his opinion: "The act also prohibits combinations which create or

carry out restrictions in trade. It has never been held that all restrictions in trade were illegal or contrary to public policy. The rule is well settled that when a contract is publicly oppressive, and the restrictions broader than necessary for the legitimate protection of the other party to be benefited by the contract, then the contract is void; otherwise it is legal. The fault of the act in regard to restraint of trade is the same in regard to competition. It makes no distinction between legal and illegal combinations and agreements which prevent competition. Those which have always been held legal, and which have always been an essential part of the liberty of the citizen, are made criminal, equally with those which the law has always condemned."

But in view of later decisions of the Supreme Court this decision cannot be regarded as of authority.

In *Niagara Fire Ins. Co. v. Cornell*, 110 Fed. 817 (1901), it was held that the Nebraska anti-trust statute was unconstitutional, because it deprived persons of the liberty to make and enforce contracts. The reasoning of the Court is, however, inconclusive.

And see *Cleland v. Anderson*, 66 Neb. 252 (1902), (92 N. W. Rep. 306), where this statute was held to be constitutional.

ment. And the same conclusion may be reached upon authority as well as upon principle, for, as already pointed out, the Supreme Court of the United States has sustained the constitutionality of two of the most sweeping of the State statutes — those of Kansas and Texas.<sup>1</sup>

As a guide for determining the constitutionality of any State anti-trust statute, resort may properly be had to the federal statute and to the decisions of the Supreme Court of the United States construing it. The power of Congress under the Fifth Amendment to regulate the right to contract is the same as that of a State under the Fourteenth Amendment.<sup>2</sup> A State statute which goes no further than the federal statute may safely be regarded as constitutional.<sup>3</sup>

### § 421. Validity of State Statutes tested by Fourteenth Amend-

<sup>1</sup> See a preceding note to this section.

<sup>2</sup> *Fifth Amendment*: "No person shall be compelled in any criminal case to be a witness against himself nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation."

*Fourteenth Amendment*: "Nor shall any State deprive any person of life, liberty, or property without due process of law."

<sup>3</sup> In *Carrol v. Greenwich Ins. Co.*, 199 U. S. 401 (1905), (26 Sup. Ct. Rep. 66), the Supreme Court of the United States said: "While we need not affirm that in no instance could a distinction be taken, ordinarily, if an act of Congress is valid under the Fifth Amendment, it would be hard to say that a State law in like terms was void under the Fourteenth. It is true that by the provision in the body of the instrument Congress has power to regulate commerce, and that the act of Congress referred to in the cases cited was passed in pursuance of that power. But even if the Fifth Amendment were read as contemporaneous with the original constitution,

the power given in the commerce clause would not be taken to override it so far as the Fifth Amendment protects fundamental personal rights. It is only on the ground that the right to combine at will is a fundamental personal right that it can be held to be protected by the Fourteenth Amendment from any abridgment by the State. . . . Many State laws which limit the freedom of contract have been sustained by this Court, and therefore an objection to this law on the general ground that it limits that freedom cannot be upheld. There is no greater sanctity in the right to combine than in the right to make other contracts. Indeed, Mr. Dicey, in his recent work on Law and Public Opinion in England during the Nineteenth Century, indicated that it is out of the very right to make what contracts one chooses, so strenuously advocated by Bentham, that combinations have arisen which restrict the very freedom that Bentham sought to attain, and which even might menace the authority of the State. If, then, the statute before us is to be overthrown, more special reasons must be assigned."

ment — (C) **Class Legislation.** — The Fourteenth Amendment, in its concluding clause, provides that no State shall “deny to any person within its jurisdiction the equal protection of the laws.”

This provision operates against arbitrary class legislation. State legislatures, in the exercise of the police power, may enact laws applying to particular classes of persons, where the nature of their business or occupation is such that its regulation is necessary for the protection of the public. The nature of the occupation is the controlling factor. Any classification, however, must rest upon a reasonable basis.<sup>1</sup> A statute which arbitrarily classifies denies the equal protection of the laws to those against whom it discriminates.

In prescribing regulations for the conduct of domestic trade, the legislature cannot exempt from their operation persons engaged in a particular branch of industry. A statute distinguishing between producers and dealers — declaring that the former may combine and that the latter may not — is unconstitutional.

Upon these principles, anti-trust statutes containing a provision that they “shall not apply to agricultural products or live stock while in the hands of the producer or raiser” — or a similar provision — are clearly invalid, and have been declared unconstitutional by the courts.<sup>2</sup> As such a provision is, essen-

<sup>1</sup> In *People v. Butler St. Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349), it was held that the exemption of corporations organized under the building, loan and homestead association laws from the operation of the Illinois anti-trust statute did not render the act unconstitutional, such corporations differing essentially from those formed for pecuniary profit.

<sup>2</sup> *Georgia*: The act of December 23, 1906, containing the exemption stated in the text, was held to be unconstitutional by reason thereof in *Brown v. Jacobs' Pharmacy*, 115 Ga. 429 (1902), (41 S. E. Rep. 553).

*Illinois*: The act of June 20, 1893, containing this exemption, was declared to be unconstitutional as class legislation in *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540 (1902), (22 Sup. Ct. Rep. 431).

With respect to the constitutionality of the Illinois act of 1891 as amended, see *People v. Butler St. Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349).

*Michigan*: The constitutionality of the anti-trust statute of this State was considered but not determined in *Merz Capsule Co. v. United States Capsule Co.*, 67 Fed. 414 (1895).

*Montana*: The provision in the anti-trust statute of this State (Penal Code, §§ 321-325), that it shall not apply to “persons engaged in horticulture or agriculture with a view of enhancing the price of their products” renders the statute unconstitutional, as denying the equal protection of the laws.

*State v. Cudahy Packing Co.*, 33 Mont. 179 (1905), (82 Pac. Rep. 833).

*Tennessee*: The act of April 30, 1897 (Laws, 1897, ch. 94), contain-

tially, a condition to the operation of the statute as a whole, its presence renders the entire statute unconstitutional. The condition could not be stricken out without rendering the statute operative against the very persons the legislature desired to exempt.<sup>1</sup>

ing this exemption, was held by the Supreme Court of Tennessee, in *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 1033), to be constitutional upon the ground that the exemption was natural and reasonable. But this decision was rendered before that of the Supreme Court of the United States in *Connolly v. Union Sewer Pipe Co.*, *supra*, and the unconstitutionality of the act was practically admitted in *State v. Witherspoon*, 115 Tenn. 138 (1906), (90 S. W. Rep. 852). The Tennessee act of 1903 (see *ante*, § 414, *note*) does not contain the exemption.

*Texas*: The act of 1889, as amended in 1895, was held to be constitutional in *Waters-Pierce Oil Co. v. State*, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 943). In *State v. Shippers' Compress, etc. Co.* (Tex. Civ. App. 1902), 67 S. W. Rep. 1049, however, the Texas Court of Civil Appeals, following the decision in *Connolly v. Union Sewer Pipe Co.*, *supra*, declared the Texas anti-trust statutes of 1895 and 1899 wholly unconstitutional. But when the case came to the Texas Supreme Court (95 Tex. 603 (1902), (69 S. W. Rep. 58)), that Court held that while the statutes were unconstitutional in some respects, so much of them as authorized the forfeiture of the charters of domestic corporations and the revocation of the licenses of foreign corporations for violation of their provisions, was valid. See also *National Cotton Oil Co. v. State* (Tex. Civ. App. 1903), 72 S. W. Rep. 615. And in *State v. Laredo Ice Co.*, 96 Tex. 461 (1903), (73 S. W. Rep. 951), it was held that the provision of

the act of 1899 that its provisions should be cumulative of all the anti-trust statutes of the State, did not incorporate in it the exemption clause of the act of 1895 and, consequently, that it was constitutional.

The present Texas anti-trust statute (see *ante*, § 414, *note*) contains no such exemption.

<sup>1</sup> *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540 (1902), (22 Sup. Ct. Rep. 431), *affirming* 99 Fed. 354 (1900). In the latter decision Judge Kohlsaat said: "It is urged that, granting the unconstitutionality of said ninth clause, yet it may be declared void without affecting the validity of the remaining clauses of said act. If this were so, then by declaring said clause void, the courts would make the act binding upon those classes of persons within the State which the legislature had especially exempted from its provisions. This would be judicial legislation of the most flagrant character. In my opinion, the said clause nine taints the whole act, and renders it all void."

See also *State v. Cudahy Packing Co.*, 33 Mont. 179 (1905), (82 Pac. Rep. 833), where the same conclusion was reached with respect to the effect of the exemption in the Montana anti-trust statute.

In *People v. Butler Steel Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349), however, it was held that the amendment of 1897, which exempted from the provisions of the Illinois trust act of 1891 combinations of producers, while itself unconstitutional, did not render the original act void, being the separate and distinct act of a different legislature. See

These principles are very clearly stated by Mr. Justice Harlan in *Connolly v. Union Sewer Pipe Company*,<sup>1</sup> holding an Illinois statute unconstitutional as class legislation: "We have seen that under that statute *all* except producers of agricultural commodities and raisers of live stock, who combine their capital, skill or acts for any of the purposes named in the act may be punished as criminals, while agriculturists and live-stock raisers, in respect of their products or live stock in hand, are exempted from the operation of the statute, and may combine and do that which, if done by others, would be a crime against the State. The statute so provides, notwithstanding persons engaged in trade or in the sale of merchandise or commodities, within the limits of a State, and agriculturists and raisers of live stock, are all in the same general class, that is, they are all alike engaged in domestic trade, which is, of right, open to all, subject to such regulations applicable alike to all in like conditions, as the State may legally prescribe. . . . If combinations of capital, skill or acts, in respect of the sale or purchase of goods, merchandise or commodities, whereby such combinations may, for their benefit exclusively, control or establish prices, are hurtful to the public interests and should be suppressed, it is impossible to perceive why like combinations in respect of agricultural products and live stock are not also hurtful. . . . To declare that some of the class engaged in domestic trade or commerce shall be deemed criminals if they violate the regulations prescribed by the State for the purpose of protecting the public against illegal combinations formed to destroy competition and to control prices, and that others of the same class shall not be bound to regard those regulations, but may combine their capital, skill or acts, to destroy competition, and to control prices for their special benefit, is so manifestly a denial of the equal protection of the laws that further argument . . . [is] unnecessary. . . . Looking at all the sections together, we must hold that the legislature would not have entered upon the policy indicated by the statute unless agriculturists and live-stock dealers were

also *State v. Shippers' Compress, etc. Co.*, 95 Tex. 603 (1902), (69 S. W. Rep. 58); *National Cotton Oil Co. v. State* (Tex. Civ. App. 1903), 72 S. W. Rep.

<sup>1</sup> *Connolly v. Union Sewer Pipe Co.*, 184 U. S. 540 (1902), (22 Sup. Ct. Rep. 431).

excluded from its operation, and were thereby protected from prosecution. The result is that the statute must be regarded as an entirety, and in that view it must be adjudged to be unconstitutional, as denying the equal protection of the laws to those within its jurisdiction who are not embraced by the ninth section."

Nebraska and Illinois anti-trust statutes<sup>1</sup> have also been held to be unconstitutional,<sup>2</sup> upon the ground that, by excepting labor organizations from their provisions, they denied the equal protection of the laws to persons not members of such organizations.

<sup>1</sup> Section 9 of the Nebraska act of April 8, 1897, reads as follows: "Nothing herein contained shall be construed to prevent any assemblies or associations of laboring men from passing and adopting such regulations as they may think proper in reference to wages and the compensation of labor."

The proviso added by the amendment of 1897 to the Illinois anti-trust statute of 1891 follows: "Provided, however, that in the mining, manufacture, or production of articles of merchandise, the cost of which is mainly made up of wages, it shall not be unlawful for persons, firms and corporations doing business in this State to enter into joint arrangement of any sort, the principal object or effect of which is to maintain or increase wages."

<sup>2</sup> *Niagara Fire Ins. Co. v. Cornell*, 110 Fed. 825 (1901): "The statute expressly excepts from its provisions assemblies or associations of laboring men. By saying that associations of laboring men are exempt from the provisions of the statute, it is thereby stated, in meaning, that unorganized labor must pay the penalties of a criminal statute for an act done by a member of an organization, and by him done with impunity. On one side, by this legislation, we have organized labor. Those men are not amenable to the statute. On the other side we have men who do not belong to organized labor, — farmers, merchants, professional men, laborers, as well as all

others. They are amenable, and by this statute that is called 'equal protection.' I do not believe it."

This decision, however, was not followed by the Supreme Court of Nebraska in *Cleland v. Anderson*, 66 Neb. 252 (1902), (92 N. W. Rep. 306). The Court said: "The section in question [exempting labor organizations for raising wages from operation of act] is inserted rather out of abundance of caution, to prevent judicial extension of the terms of the act beyond its scope and purpose, than to grant a privilege or immunity to persons who would otherwise fall within its terms. The distinction between goods and merchandise produced by skill and labor, and the skill and labor which produce them, is manifest and reasonable. The statute does not say that laborers who have goods, wares or merchandise, the produce of labor, for sale, may combine to advance or control the price, but only that the law designed to prevent combinations in restraint of trade in such articles, when produced, shall not be construed to affect organizations formed to regulate the wages of compensation of the labor and skill which produce them."

The amendment of 1897 to the Illinois act of 1891, exempting from its provisions combinations for raising or maintaining wages, was declared to be unconstitutional in *People v. Butler St. Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349).

The recent State anti-trust acts omit all these exemptions, and they have been eliminated by amendment from several of the earlier statutes. With few exceptions, the present anti-trust statutes are not open to the objection that they constitute class legislation.

§ 422. **Validity of State Statutes under State Constitutional Provisions.** — The section of the Illinois anti-trust statute<sup>1</sup> requiring corporations, under penalties, to answer upon oath inquiries from the Secretary of State as to whether they are violating the provisions of such statute, and providing that no one shall be subject to criminal prosecution by reason of anything truthfully so declared, is not unconstitutional as involving an assumption of judicial powers by the legislature.<sup>2</sup> Nor is it in conflict with the constitutional provision that "no person shall be compelled in any criminal case to give evidence against himself."<sup>3</sup> The immunity afforded by the statute is a full protection against prosecution.<sup>4</sup>

That the provision of the Michigan anti-trust act of 1889, that it should not apply to "the services of laborers or artisans who are formed into societies or organizations for the benefit and protection of their members," rendered the act unconstitutional, see *Davis v. Booth*, 131 Fed. 31 (1904). The Michigan act of 1899 omitted this provision.

<sup>1</sup> Act of 1891 as amended in 1893 (*Hurd's Illinois Rev. St.* 1899, p. 616).

<sup>2</sup> *People v. Butler St. Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349). In this case the Court said (p. 255): "It is said that the amendment of 1893 is unconstitutional in this: that it is an attempt upon the part of the legislature to exercise judicial power. . . These objections, in our opinion, are without force. The statute in apt terms provides that the affidavit shall be filed in reply to the letter of inquiry. If the legislature may require the affidavit to be filed, as we think it may, we can see no valid reason why it may

not provide that a failure in that regard shall subject the offending party to a penalty to be adjudged against it by the courts, without it being said that the legislature has exceeded its jurisdiction by exercising judicial power."

<sup>3</sup> Illinois Const. Art. 2, § 10.

<sup>4</sup> *People v. Butler St. Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349), where the Court also said (p. 247): "If the statute be confined to its legitimate constitutional scope its proper construction only requires the affidavit to state whether or not the corporation upon whose behalf it is made had violated the statute by performing some one or more of the acts therein prohibited within the State of Illinois, and would not include, but would exclude, all acts which would connect it with any trust, pool, combination, etc., formed outside of the State, and which would violate the anti-trust statute of the United States. . . We conclude, therefore, that the officer making the affidavit, and the corporation in



On the other hand, it was held that a section of the Missouri statute of 1889 similar to that of the Illinois statute was unconstitutional as being in conflict with the provision against self incrimination.<sup>1</sup> But this statute contained no immunity provision, and the unconstitutionality of the particular section was later held not to affect the validity of the statute as a whole.<sup>2</sup>

whose behalf the same is made, are fully protected by the statutory immunity from a prosecution by any other State or by the federal authorities. . . . As a corporation exists or does business in this State only by virtue of a charter granted to it by the State or by the permission of the State, we see no valid reason why it may not require a corporation existing or doing business in this State to file the affidavit provided by the statute, even though it is provided that individuals, when acting alone or in partnership with others, are exempted from so doing. The object of the statute of 1891 as amended, is twofold: to prohibit trusts, pools and combines for the purpose of limiting production and fixing the prices of commodities within the State, and to have supervision and control over corporations created or doing business in this State for the purpose of determining whether they are members of trusts, pools and combines. The placing of corporations in a class by themselves and requiring them to file the anti-trust affidavit, leaving individuals and partnerships simply liable to the penalties provided for by the act, is not an illegal or arbitrary classification, any more than is the requirement that State banking institutions shall file reports with the auditor of State or insurance companies with the insurance department of the State."

And in *State v. Jack*, 69 Kan. 387 (1904), (76 Pac. Rep. 911), *affirmed* 199 U. S. 372 (1905), (26 Sup. Ct.

Rep. 73), the Supreme Court of Kansas said of a similar provision: "Section 10 of the act contemplates a proceeding or investigation before the district court or district judge to inquire if there has been violation of that law. The record discloses the examination of appellant upon the inquiry to have been confined to its legitimate scope. Within the scope of the inquiry, the immunity afforded appellant by section 10 was coextensive with the constitutional privilege invoked for his protection. The possibility that his answers to the inquiries might disclose violations of the federal anti-trust law, and the evidence thus given be used against him in a criminal prosecution for a violation of that law, was not a real and probable danger of criminal prosecution within the constitutional privilege that no person shall be a witness against himself."

In this connection it should be noted that it has been held that a similar provision in an Arkansas statute created no offence and that the mere failure to file the affidavit did not constitute a violation of the statute.

*State v. International Harvester Co.*, 79 Ark. 517 (1906), (96 S. W. Rep. 119).

See also *In re Bell*, 69 Kan. 855 (1904), 76 Pac. Rep. 1129.

<sup>1</sup> *State v. Simmons Hardware Co.*, 109 Mo. 118 (1891), (18 S. W. Rep. 1125).

<sup>2</sup> *Finck v. Schneider Granite Co.*, 187 Mo. 244 (1905), (86 S. W. Rep. 213, 106 Am. St. Rep. 452).

The Texas anti-trust law <sup>1</sup> is not in conflict with the constitutional provision of that State that excessive fines shall not be imposed,<sup>2</sup> there being a wide range between the maximum and minimum penalties and the latter not being excessive. In so holding the Supreme Court of Texas said: "Prescribing fines and other punishments which may be imposed upon violators of the law is a matter peculiarly within the power and discretion of the legislature, and the courts have no right to control or restrain that discretion, except in extraordinary cases, where it becomes so manifestly violative of the constitutional inhibition as to shock the sense of mankind."<sup>3</sup>

The Ohio anti-trust statute <sup>4</sup> was held by a lower court of that State to be unconstitutional as interfering with "the inalienable right of enjoying liberty and acquiring property guaranteed by section 1 of the bill of rights of the constitution."<sup>5</sup> Upon appeal to the Supreme Court, however, the act was declared to be constitutional.<sup>6</sup>

The provision of the Kentucky constitution,<sup>7</sup> requiring the legislature to enact laws to prevent trusts and combinations, is not a grant of power and does not impliedly prohibit the legislature from going beyond the duty enjoined. Consequently, a

<sup>1</sup> Acts 1899, ch. 146, p. 246.

<sup>2</sup> Art. 1, § 13.

<sup>3</sup> *State v. Laredo Ice Co.*, 96 Tex. 461 (1903), (73 S. W. Rep. 951).

The Texas anti-trust statute of 1903 imposing a penalty for each day's offence of carrying on a trust is not unconstitutional as impairing the obligation of contracts although applying to trusts formed before, but carried on after, its enactment.

*State v. Missouri, etc. R. Co.*, 99 Tex. 516 (1906), (91 S. W. Rep. 214).

<sup>4</sup> Act of 1898, called the Valentine Anti-trust Act, 93 Ohio Laws, 143.

<sup>5</sup> *Gage v. State*, 24 Ohio C. C. 724 (1904).

<sup>6</sup> *State v. Gage*, 72 Ohio St. 210 (1905), (73 N. E. Rep. 1078). "Within the limits of the present case, it is obvious that the effect of the statute is to prohibit affirma-

tively such contracts and transactions as were previously unlawful, but which could be so adjudged only when the aid of the courts was invoked for their enforcement. It must be obviously unavailing to urge the constitutionally protected right to make contracts with reference to one's property and his faculties as an objection to a statute which does not prohibit or restrain the power of making such contracts. Examination of the various cases cited in the briefs shows that legislation having the same object as this and making similar, if not identical, prohibitions has been quite generally sustained as a valid exercise of legislative power."

See also *State v. Jacobs*, 7 Ohio N. P. 261 (1899).

<sup>7</sup> *Kentucky*, Const. § 198. This provision is printed in the note to § 414, *ante*.

more rigorous anti-trust statute<sup>1</sup> than the constitution requires is valid.<sup>2</sup>

The Arkansas constitution forbids unreasonable searches and seizures of persons, papers and effects.<sup>3</sup> The anti-trust statute of the State authorizes orders requiring, under penalty of a default judgment against the corporation sued for violating the act, non-resident officers of such corporation to appear and testify before a commission and to produce books and papers. It is held that the provisions of the statute are not in conflict with the constitutional provision in so far as they authorize a reasonable order for the production of the papers of a corporation over which the State has control.<sup>4</sup> It is also held that the provisions of such statute authorizing the recovery of penalties from foreign corporations violating its provisions are not in conflict with the Arkansas constitutional provision<sup>5</sup> that no person shall be held to answer a criminal charge unless upon the indictment of a grand jury.<sup>6</sup>

§ 423. **State Courts' Interpretation of State Statute followed by Federal Courts in determining its Constitutionality.** — The decision of the highest court of a State that a State statute does not contravene a State constitutional provision is, manifestly, binding upon the federal courts.<sup>7</sup>

But the controlling effect of a local construction of a local law is not confined to cases where the statute is tested by the State constitution. Where the courts of a State have declared what a State statute means their interpretation will be followed by the federal courts where the claim is made that it is in conflict with the federal constitution.<sup>8</sup> In *Smiley v. Kan-*

<sup>1</sup> *Kentucky, Stat.* § 3915.

<sup>2</sup> *Commonwealth v. Bavarian Brewing Co.*, 112 Ky. 925 (1902), (23 Ky. Law Rep. 2334, 66 S. W. Rep. 1016).

<sup>3</sup> *Arkansas, Const. Art. 2, § 15.*

<sup>4</sup> *Hammond Packing Co. v. State*, 81 Ark. 519 (1907), (100 S. W. Rep. 407).

<sup>5</sup> *Arkansas, Const. Art. 2, § 8.*

<sup>6</sup> *Hammond Packing Co. v. State*, 81 Ark. 519 (1907), 100 S. W. Rep. 407.

<sup>7</sup> *Jack v. Kansas*, 199 U. S. 372 (1905), (26 Sup. Ct. Rep. 73).

<sup>8</sup> *Smiley v. Kansas*, 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289); *Jack v. Kansas*, 199 U. S. 372 (1905), (26 Sup. Ct. Rep. 73); *National Cotton Oil Co. v. Texas*, 197 U. S. 115 (1905), (25 Sup. Ct. Rep. 379).

In the last case the Supreme Court said (p. 130): "There are cases in which we determine for ourselves the meaning of a State law, but this is not one of them. The contention of the company is that the statutes of the State discriminate against it;

*sas*<sup>1</sup> Mr. Justice Brewer said: "It may be conceded for the purposes of this case that the language of the first section is broad enough to include acts beyond the police power of the State and the punishment of which would unduly infringe upon the freedom of contract. At any rate we shall not attempt to enter into any consideration of that question. The Supreme Court of the State held that the acts charged and proved against the defendant were clearly within the terms of the statute, as well as within the police power of the State; and that the statute could be sustained as a prohibition of those acts irrespective of the question whether its language was broad enough to include acts and conduct which the legislature could not rightfully restrain. It is well settled that in cases of this kind the interpretation placed by the highest court of the State upon its statutes is conclusive here. We accept the construction given to a State statute by that court."

§ 424. **Who may question Constitutionality of Statutes.** — It is held that objections to the constitutionality of an anti-trust statute, as infringing the rights guaranteed by the Fourteenth Amendment, can only be made by a person against whom such statute is sought to be enforced. Thus the Supreme Court of the United States has quoted with approval this language of the Kansas Supreme Court:<sup>2</sup> "He [the defendant] cannot be heard to object to the statute merely because it operates oppressively upon others. The hurt must be to him-

in other words, deny it the equal protection of the law, by forbidding it from doing what they permit others to do in similar circumstances — punish its acts and exempt from punishment the same acts when done by others. But the courts of the State are the tribunals appointed to administer the statutes and impose their penalties and to do so they must necessarily interpret them. In other words, they are the tribunals to declare the meaning of the statutes, and if in declaring it they make the statutes discriminatory, then may the statutes become unconstitutional."

<sup>1</sup> *Smiley v. Kansas*, 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289).

<sup>2</sup> *Smiley v. Kansas*, 196 U. S. 456 (1905), (25 Sup. Ct. Rep. 289). The quotation is from the decision of the Kansas Court in the same case: 65 Kan. 240 (1902), (69 Pac. Rep. 199, 67 L. R. A. 903).

And in the *Winnebago*, 205 U. S. 360 (1907), (27 Sup. Ct. Rep. 509), the Supreme Court again said: "In a case from a State court this court does not listen to objections of those who do not come within the class whose constitutional rights are alleged to be infringed, or hold a law unconstitutional, because, as against a class making no complaint, the law might be so held."

self. The case, under appellant's contention as to this point, is not a case of favoritism in the law. It is not a case of exclusion of classes who ought to have been included, the leaving out of which constitutes a denial of the equal protection of the law, but it is the opposite of that. It is a case of the inclusion of those who ought to have been excluded. Hence, unless appellant can show that he himself has been wrongfully included in the terms of the law, he can have no just ground of complaint. This is fundamental and decisively settled."

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## CHAPTER XLII

### CONSTRUCTION AND APPLICATION OF STATE ANTI-TRUST STATUTES

- § 425. Definitions.
- § 426. Statutes not Regulations of Interstate Commerce.
- § 427. Rule of Construction.
- § 428. Form of Combination Immaterial. Application of Statutes to Holding and Purchasing Corporations.
- § 429. Objects and Tendencies of Combination as determining Application of Statutes.
- § 430. Extent of Combination as determining Application of Statutes.
- § 431. Application of Statutes to Ancillary Contracts in Restraint of Trade.
- § 432. Application of Statutes to Agency and Other Exclusive and Restrictive Contracts. Sales and Leases.
- § 433. Application of Statutes to Particular Associations of Manufacturers and Dealers.
- § 434. Application of Statutes to Combinations under Patents and Copyrights.
- § 435. Application of Statutes to Insurance Combinations.
- § 436. Application of Statutes to Foreign Corporations doing Local Business.
- § 437. Statutes have no Extraterritorial Force.
- § 438. Application of Statutes to Agreements of *Quasi*-public Corporations.
- § 439. Effect of Statutes upon Exercise of Statutory Authority to consolidate or hold Stock.
- § 440. Statutes Inapplicable to Contracts with State.
- § 441. Statutes Inapplicable where Other Statutes eliminate Competition.
- § 442. Statutes do not supersede Common Law.
- § 443. Statutes not Retroactive, but apply to Continuing Combinations.
- § 444. Construction and Application of Miscellaneous Statutes.

§ 425. Definitions. — The anti-trust statutes of several States themselves define the words "trust," "monopoly" and "com-

bination" used therein.<sup>1</sup> Definitions of these and similar terms as employed in such statutes also appear in judicial decisions.

Thus to constitute a "trust" under the Texas statute<sup>2</sup> there must be a "combination of capital, skill and acts." The term "combination" as so employed means "union" or "association." And a union or association to come within the statute must be of agencies which might otherwise have been independent and competing.<sup>3</sup>

A "monopoly" within the meaning of the Texas statute not only includes that which is embraced by that term used in its primary sense but any combination the tendency of which is to prevent competition and to control prices to the public injury.<sup>4</sup>

The Mississippi statute<sup>5</sup> declares that a "trust" or "combine" is a combination which is in restraint of trade, to increase prices, to limit production, etc., and "is inimical to the public welfare, unlawful and a conspiracy." The last phrase, however, merely states the effect of the "trust" as already defined, and is not an added element of the definition.<sup>6</sup>

A "trust" under the Missouri statute "is a contract, combination, confederation or understanding, express or implied, between two or more persons, to control the price of a commodity or service for the benefit of the parties thereto, and to the injury of the public, and which tends to create a monopoly."<sup>7</sup>

<sup>1</sup> See *ante*, § 414, note: "*The Statutes. Development of State Legislation.*"

<sup>2</sup> Texas Rev. Stat., 1895, Art. 5313.

<sup>3</sup> *Gates v. Hooper*, 90 Tex. 563 (1897), (39 S. W. Rep. 1079).

<sup>4</sup> *Jones v. Carter* (Tex. Civ. App. 1907), 101 S. W. Rep. 514. See also *ante*, §§ 332, 389.

<sup>5</sup> *Ante*, § 414, note: "*The Statutes. Development of State Legislation.*"

<sup>6</sup> *Barataria Canning Co. v. Jouliau*, 80 Miss. 555 (1902), (31 So. Rep. 961). In this case it was also held that oysters, canned and sold as merchandise, were a "commodity" within the meaning of the statute.

<sup>7</sup> *State v. Firemen's Fund Ins. Co.*, 152 Mo. 1 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363).

In *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 454 (1904), (75 Pac. Rep. 89), the Supreme Court of Montana said of the term "trust" as used in the anti-trust statute of that State: "The term 'trust,' if assigned the meaning given to it by the text-writers, includes any form of combination between corporations, or corporations and natural persons, for the purpose of regulating production and repressing competition by means of the power thus centralized. . . . The section of the statute quoted involves the same idea and demands the same construction, though it is more specific in its provisions, and extends to and includes combinations in restraint of competition in transportation. It denounces any

The term "control," as used in the Mississippi statute, which a corporation is forbidden to grant to others than its officers or agents, means power to dictate corporate action and not merely to manage a department of the corporation's business.<sup>1</sup>

§ 426. **Statutes not Regulations of Interstate Commerce.** — State legislatures have only power to legislate concerning combinations affecting commerce wholly within the State.<sup>2</sup> Commerce across State lines is outside their sphere. A State anti-trust statute, therefore, while broad enough in terms to embrace combinations in restraint of interstate commerce will be limited by construction to those to which alone it can lawfully apply — combinations affecting domestic trade and commerce.<sup>3</sup> And

form of combination or contract which has for its purpose, directly or indirectly, the restraint of production or trade in any way or manner, or the control of the price of any article of consumption by the people. It was not the purpose of the convention, or of the legislature, to limit either the terms used in the constitution, or in the statute, by any narrow definition, but to leave it to the courts to look beneath the surface, and, from the methods employed in the conduct of the business, to determine whether the association or combination in question, no matter what its particular form should chance to be, or what might be its constituent elements, is taking advantage of the public in an unlawful way."

<sup>1</sup> *Yazoo, etc. R. Co. v. Searles*, 85 Miss. 520 (1905), (37 So. Rep. 939, 68 L. R. A. 715) citing § 294 of this work.

A boycott is a combination for the purpose of creating and carrying out a restriction in trade within the meaning of the Ohio statute.

*State v. Jacobs*, 7 Ohio N. P. 261 (1899).

In view of the other provisions of the Tennessee statute relating to corporations the words "person or persons" as used in the section prescribing penalties of fine or imprison-

ment for violating its provisions do not embrace corporations.

*Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (n. s.) 1015).

<sup>2</sup> That part of the South Carolina statute which prohibits the importation into, and sale within, the State of articles with a view to lessening free competition is invalid as an attempted regulation of interstate commerce.

*State v. Virginia-Carolina Chemical Co.*, 71 S. C. 544 (1904), (51 S. E. Rep. 455).

<sup>3</sup> *State v. Smiley*, 65 Kan. 240 (1902), (69 Pac. Rep. 199, 67 L. R. A. 903), *affirmed* 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289): "A State legislature is empowered to legislate generally in respect to trusts and conspiracies in restraint of trade, except as limited by the commerce clause of the federal Constitution; but, on the other hand, Congress is not empowered to legislate generally with respect to trusts and trade conspiracies. It can legislate against them only under the commerce clause of the Constitution. Therefore, a State enactment, though broad enough in terms to apply to trusts engaged in interstate commerce, or conspiracies in restraint of interstate trade, will be limited by con-

the decisions of the State courts so limiting the general language of the State statutes will be accepted as correct interpretations of them by the federal courts.<sup>1</sup>

§ 427. **Rule of Construction.** — State anti-trust statutes, being penal in their nature, must be strictly construed. Their meaning cannot be extended by implication.<sup>2</sup> General language

struction to that to which it can alone legally apply; but a congressional act, being of necessity limited to the one particular class of trusts or trade conspiracies, viz., those engaged in interstate or international trade, must express that limitation on its face. Nevertheless, we do not doubt that if a congressional enactment, general in terms, could be given specific application to subjects lying within its rightful sphere, without the aid of other and qualifying and explanatory words, but which general terms were also inclusive of subjects lying without such sphere, it would be restrained by construction to those matters in respect of which Congress is qualified to dispense, and not be nullified as a whole."

In *People v. Butler St. Foundry, etc. Co.*, 201 Ill. 236 (1903), (66 N. E. Rep. 349), it was held that while the terms of the Illinois anti-trust statute were broad enough to include combinations which might violate the federal anti-trust statute, it should be construed as relating only to transactions occurring within the limits of the State.

*Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 709, 10 L. R. A. (n. s.) 1015): "The statute, when properly construed, does not apply to interstate commerce. The sole object and purpose of the enactment of it was to correct and prohibit abuses of trade within the State. This was the legislative intent, and will prevail over the literal meaning of words or terms found in the act."

See also *Hadley Dean Co. v.*

*Highland Co.*, 143 Fed. 242 (1906); *State v. Phipps*, 50 Kan. 609 (1893), (31 Pac. Rep. 1097, 34 Am. St. Rep. 152, 18 L. R. A. 657); *Fuqua v. Pabst Brewing Co.*, 90 Tex. 298 (1897), (38 S. W. Rep. 29); *Waters-Pierce Oil Co. v. State*, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 945); *Pasteur Vaccine Co. v. Burkey*, 22 Tex. Civ. App. 232 (1899), (54 S. W. Rep. 804).

In *S. S. White Dental Mfg. Co. v. Hertzberg* (Tex. Civ. App., 1899), 51 S. W. Rep. 355, it was held that where the invalidity of a contract under the Texas anti-trust statute arose only after the delivery of articles within the State, the operation of the statute would not be defeated by the fact that the delivery within the State had been by means of interstate commerce.

<sup>1</sup> *Waters-Pierce Oil Co. v. State*, 177 U. S. 43 (1900), (20 Sup. Ct. Rep. 580); *Smiley v. Kansas*, 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289). See also *ante*, § 423.

<sup>2</sup> In *State v. Lancashire Fire Ins. Co.*, 60 Ark. 472 (1899), (51 S. W. Rep. 633, 45 L. R. A. 348), the Supreme Court of Arkansas, in construing the anti-trust statute of that State, said: "To determine the meaning of a statute, the courts must look mainly to the language of the act itself; for that is the final expression of the legislative will, and therein must such will and intention be sought. Whatever the legislature may have intended, such intention can have no effect unless expressed in the statute; for this, being a penal statute, cannot be extended by implication. It would be in the highest degree unjust



will be limited in its application to such objects and persons as it is reasonable to presume the legislature intended to deal with.<sup>1</sup>

§ 428. **Form of Combination Immaterial. Application of Statutes to Holding and Purchasing Corporations.** — State anti-trust statutes, while broader than the rules of public policy and covering a different field from the federal enactment, have a common purpose — the preservation of competition — and are governed in their application by similar principles. It follows, therefore, from the principles already stated that the test whether a combination is in violation of a State statute lies in its object or tendencies and not in its form.<sup>2</sup> The form assumed by a combination is immaterial.<sup>3</sup>

The corporate form of combination in no way prevents the application of the statutes. The corporation as an entity may not be able to create a combination, but its acts, within the purview of the statutes, will be taken as the acts of the persons composing it. Its stockholders may, in controlling it and in conjunction with it, create an unlawful combination.<sup>4</sup>

to punish conduct not clearly forbidden by the law itself . . . and so, to quote the words of a recent opinion of the Supreme Court of the United States, 'we are left to determine the meaning of this act, as we determine the meaning of other acts, from the language used therein.'" Citing *United States v. Trans-Missouri Freight Ass'n*, 166 U. S. 318 (1897), (17 Sup. Ct. Rep. 540).

See also *State v. Associated Press*, 159 Mo. 410 (1901), (60 S. W. Rep. 91, 51 L. R. A. 151).

<sup>1</sup> *State v. Smiley*, 65 Kan. 240 (1902), (69 Pac. Rep. 199, 67 L. R. A. 903), *affirmed* 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289).

<sup>2</sup> See *ante*, § 354: "*Analysis of Rule governing Private Corporations. Form of Combination Immaterial.*" *Ante*, § 397: "*Form of Combination Immaterial. Illegality of Corporate Device.*"

<sup>3</sup> *Jones v. Carter* (Tex. Civ. App.

1907), 101 S. W. Rep. 514; *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705).

<sup>4</sup> An association of dealers formed for the purpose of regulating the price of an article in a particular locality which is carried out by the concurrent action of the association and its members is in conflict with the Illinois statute. And the fact that the association is incorporated does not affect its illegality, upon the theory that a corporation cannot alone constitute a trust. Its act, within the purview of the statute, is the act of the persons associated together. In so holding the Court, in *Ford v. Chicago Milk Shippers Ass'n*, 155 Ill. 179 (1895), (39 N. E. Rep. 651, 27 L. R. A. 298), said: "It is urged that the corporation cannot alone enter into a trust or combination that would be a violation of this statute. Whilst it is true as a general proposition that a corporation may be created and consti-

And where a corporation is organized for the purpose of effecting an unlawful scheme of combination its acts when organized in carrying out the arrangement constitute a violation of an anti-trust statute.<sup>1</sup>

A combination by means of a holding corporation when affecting intrastate commerce is as much in violation of an appropriate State statute against combinations as such a combination is in contravention of the federal statute when affecting interstate commerce.<sup>2</sup> In such a case, it is not material whether the holding corporation is foreign or domestic and to determine its purposes the court will look through the various steps which led to its organization.<sup>3</sup> While the State may have granted power to the holding corporation to hold shares in other corporations it acquired no right to exercise such power in violation of the anti-trust statutes of the State.<sup>4</sup> Without statutory

tuted a legal entity, existing separate and apart from the natural persons composing it, yet it cannot act independently, or against the will, or abstain from complying with the direction, of the natural persons who constitute the corporate body. A corporation is, in fact, an association of persons united in one body, having perpetual succession, vested with political rights conferred upon it by the authority creating it. Such being the nature of the corporate body, acts done by it are the acts of the associated persons as corporators or as individuals, and in which capacity the act is done must be determined from the nature and character of the act and the purpose for which the corporation was organized. And when the acts of the corporate body are violative of the statutes of the State and would be a misdemeanor that would subject it to punishment in accordance with law, such acts are wholly without the power of the corporation, as the statute will create no body with authority to violate its laws. . . . There can be no immunity for evasion of the policy of the State by its own creations. The cor-

poration as an entity may not be able to create a trust or combination with itself, but its individual shareholders may, in controlling it, together with it, create such trust or combination that will constitute it, with them, alike guilty."

<sup>1</sup> Attorney-general v. A. Booth & Co., 143 Mich. 89 (1906), (106 N. W. Rep. 868).

<sup>2</sup> See *ante*, § 397a: "*The Northern Securities Case.*"

<sup>3</sup> Southern Electric Securities Co. v. State (Miss. 1907), 44 So. Rep. 785.

See also Dunbar v. American Telephone, etc. Co., 224 Ill. 9 (1906), (79 N. E. Rep. 423, 115 Am. St. Rep. 132); Bigelow v. Calumet, etc. Mining Co., 155 Fed. 874 (1907); MacGinnis v. Boston, etc. Mining Co., 29 Mont. 428 (1904), (75 Pac. Rep. 89).

<sup>4</sup> Bigelow v. Calumet, etc. Mining Co., 155 Fed. 874 (1907): "The result of these two statutes is that power was given to the Calumet & Hecla Company to purchase stock in the Osceola Company, but the right to exercise that power in violation of the anti-monopoly statutes of the State was not given."

authority it had no power to purchase such shares at all. With such authority it had only the right to purchase for lawful purposes.

Upon similar principles, a combination formed by means of a purchasing corporation undoubtedly violates the State anti-trust statutes.<sup>1</sup> But an actual purchase and sale, as distinguished from a combination in the form of a sale, does not violate them. Thus it has been held that it is not contrary to such a statute for a manufacturing corporation to purchase the plant and property of another corporation engaged in the same business, for a cash consideration and in good faith.<sup>2</sup>

§ 429. **Objects and Tendencies of Combination as determining Application of Statutes.** — Both the objects and the natural consequences of the operation of a combination must always be considered in determining whether there has been a violation of a State anti-trust statute. The test of the validity of an agreement is not alone what the parties intend but what its effect will be.<sup>3</sup> And while, as we have seen,<sup>4</sup> further testing the agreement by its tendencies is making a standard of that which

<sup>1</sup> For consideration of this subject, see *ante*, § 354: "*Analysis of Rule governing Private Corporations. Form of Combination Immaterial.*"

<sup>2</sup> *State v. Continental Tobacco Co.*, 177 Mo. 1 (1903), (75 S. W. Rep. 737). In this case the Court said (p. 32): "On the other hand, the terms of the statute are not broad enough to prohibit one corporation, in good faith, in the legitimate pursuit of its business, from purchasing the assets of another corporation in a similar business. Its terms are applicable to individuals and partnerships, as well as corporations; its condemnation is as pronounced against the individual as it is against the corporation; hence it follows, if this statute is to be construed as prohibiting corporations from purchasing, in good faith, the assets of another corporation, it must be applied with equal force to the rights and powers of individuals."

See also *Davis v. Booth*, 131 Fed. 31 (1904).

<sup>3</sup> *Yazoo, etc. R. Co. v. Searles*, 85 Miss. 520 (1905), (37 So. Rep. 939, 68 L. R. A. 723): "But at last the test, and only test, is, not what the intent of the parties may be, not what form the combination has taken, but what will its probable effect be? If unlawful or oppressive, if obnoxious to public policy, if inimical to public welfare, they will be denounced, and punishment meted out to every participant; otherwise courts will not limit or restrict the inalienable right of contract, and will not interfere unless the violation of law be apparent, or the apprehended evil effect assume some tangible form." (Citing this treatise.)

See also *MacGinnis v. Boston, etc. Mining Co.*, 29 Mont. 428 (1904), (75 Pac. Rep. 89).

<sup>4</sup> See *ante*, § 355: "*Analysis of Rule. Objects and Tendencies of Combination.*"

is necessarily uncertain, still such test is applied by the courts in determining the applicability of State anti-trust statutes.<sup>1</sup>

In the very recent case of *Standard Oil Co. v. State*<sup>2</sup> the Supreme Court of Tennessee said: "The making of the agreement . . . with a view to lessen competition, and which tended to do so, is thus fully proven. This is all that is necessary to constitute a violation of the statute. The statute was not only intended to prohibit contracts and combination between those engaged in the same business, made for the purpose, or which had a tendency, to destroy all competition, and which are injurious to the whole public, but those made and formed by any and all persons with a view, or which in their nature tend, to lessen competition to any material extent, to the injury of any part of the people of the State. The number of persons, generally speaking, engaged in the conspiracy, the extent of the ter-

<sup>1</sup> *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015); *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904); *Dunbar v. American Telephone, etc. Co.*, 224 Ill. 9 (1906), (79 N. E. Rep. 423, 115 Am. St. Rep. 132); *Jones v. Carter* (Tex. Civ. App. 1907), 101 S. W. Rep. 514.

*Ferd Heim Brewing Co. v. Belinder*, 97 Mo. App. 64 (1902), (71 S. W. Rep. 691): "What is the tendency of the agreement? It does not affect the character of the agreement proved, that the brewers only intended a worthy purpose. Intention will not avail when the effect is within the statutes. And it has been held by the highest authority that, though no imposition was consummated by the raising of prices; and even though the agreement was necessary to curb against unjust or ill-advised competition, yet if the effect of the agreement was within the prohibition of the law, it was void."

*Walter A. Wood Mowing, etc. Mach. Co. v. Greenwood Hardware Co.*, 75 S. C. 383 (1906), (55 S. E. Rep. 973): "In determining whether

a particular contract falls within the inhibition of the statute (against monopolies) the Court must necessarily consider the tendency or power of the contract to injure the public, either considered in itself or as a part of a scheme to destroy or impede competition and control supply and prices. A contract may be lawful in itself as an isolated matter, but yet be unlawful as a part of a scheme to create a virtual monopoly. The immediate effect of a trust or combination may be really beneficial to the public, improving the quality of goods or services and reducing the price, yet if it has inherent capability or natural tendency to injure the public, then competition is stifled and control of supply and prices secured and it is obnoxious to the statute. The main general test should be whether the contract, trust or combination is monopolistic in purpose or natural tendency. If so it unreasonably affects competition and prices to the detriment of the public and is obnoxious to the statute."

<sup>2</sup> *Standard Oil Co. v. State*, 117 Tenn. 618, 659 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015).

ritory affected, the degree which it was intended or has a tendency to lessen competition, the extent of the injury to the public, or whether it be permanent or temporary in its character, are not material elements of the offence. The form of the combination is also a matter of indifference. No forms or precedents are followed in the commission of crime. In any form the agreement may be made, or disguise in which it may appear, or whatever scheme may be adopted to accomplish the prohibited acts, it is within the statute. It is enough that the contract was made with a view to lessen competition in the sale of an article of commerce of prime necessity, and that it is injurious to the public, however limited and restricted it may be in its scope, effect, duration. It is its purpose, tendency, and effect that makes it unlawful."

§ 430. **Extent of Combination as determining Application of Statutes.** — To establish a violation of State statutes against monopolies — the term being used in its modern sense — a complete monopoly need not be shown.<sup>1</sup> Similarly, statutes against combinations affecting competition to the detriment of the public not only embrace those combinations and agreements made for the purpose of, or which tend toward, destroying all competition to the injury of the whole public, but those which tend to lessen competition to any material extent to the injury of any part of the public.<sup>2</sup> And when the statute is directed against combinations to regulate or fix prices injury to the public need not be shown.<sup>3</sup>

Upon these principles, it was held that a combination of retail dealers to prevent sales by wholesale dealers to retailers not in the combination violated the Nebraska anti-trust statute regardless of the proportion of dealers in the trade outside the combination.<sup>4</sup> So it has been held that the application of the

<sup>1</sup> *State v. Armour Packing Co.*, 173 Mo. 356 (3), 190 (73 S. W. Rep. 645, 61 L. R. A. 464); *Hunt v. Riverside Coöperative Club*, 140 Mich. 538 (1905), (104 N. W. Rep. 40, 112 Am. St. Rep. 420); *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015); *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E.

Rep. 770), *affirming* 114 Ill. App. 75 (1904).

<sup>2</sup> *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015).

<sup>3</sup> *State v. Armour Packing Co.*, 173 Mo. 356 (1903), (73 S. W. Rep. 645, 61 L. R. A. 464).

<sup>4</sup> *Cleland v. Anderson*, 66 Neb. 252 (1902), (92 N. W. Rep. 306).

Illinois statute does not depend upon the number of those implicated in its violation nor the extent of the territory covered by the combination.<sup>1</sup>

§ 431. **Application of Statutes to Ancillary Contracts in Restraint of Trade.** — As already shown, contracts in restraint of trade — using the phrase in its original sense — were agreements auxiliary to a principal contract — usually the sale of a business — by a party thereto to refrain from engaging in some trade or occupation for a certain time in a particular territory.<sup>2</sup>

While the effect of such agreements is in a degree to restrain competition, their primary object is to protect the purchaser of the good-will of a business and, when reasonable, they have always been sustained at common law. They have also, as we have seen, been held to be outside the application of the federal anti-trust statute.<sup>3</sup>

One, at least, of the State anti-trust statutes expressly excludes these ancillary contracts from its operation,<sup>4</sup> and other statutes have been held not to apply to them.<sup>5</sup>

<sup>1</sup> Chicago, etc. Coal Co. v. People, 214 Ill. 421 (1905), (73 N. E. Rep. 770), affirming 114 Ill. App. 75 (1904).

<sup>2</sup> See ante, ch. XXXIII.: "*Application of Law of Contracts in Restraint of Trade.*"

<sup>3</sup> Ante, § 387: "*Use of Phrase 'Contract in Restraint of Trade.' Application of Statute to Ancillary Contracts.*"

<sup>4</sup> See § 6 of Michigan act of 1905, in note to § 414: "*The Statutes. Development of State Legislation.*"

For construction of the Michigan statutes see Davis v. Booth, 131 Fed. 31 (1904).

<sup>5</sup> An agreement by the vendor of a business not to engage in a similar business in a certain territory is not in violation of the Minnesota anti-trust statute of 1899.

Espenson v. Kolpe, 93 Minn. 278 (1904), (101 N. W. Rep. 168).

An agreement by one party to employ at certain wages another engaged in the same line of business provided he will give up his business

and enter the service of the former has been held not to contravene the Ohio anti-trust act of 1898.

Kevil v. Standard Oil Co., 8 Ohio N. P. 311, 11 Ohio S. & C. P. Dec. 114 (1900).

An agreement by a merchant in selling out his business that he will not engage in business in the town for a period of twelve months does not create a "trust" under the Texas statute.

Gates v. Hooper, 90 Tex. 563 (1897), (39 S. W. Rep. 1079).

See also Crump v. Ligon (Tex. 1904), 84 S. W. Rep. 250.

But an ancillary contract by the vendor of a business not to reënter such business for a certain period and in a particular place is in violation of the Texas anti-trust statute of 1895, where it also appears that the purchasers of the business were the only dealers engaged in that business in such locality and combined and made the purchase for the purpose of eliminating competition.

§ 432. **Application of Statutes to Agency and Other Exclusive and Restrictive Contracts. Sales and Leases.**—The State anti-trust statutes are directed against contracts and combinations in restraint of competition to the public injury. It is not their purpose to interfere with ordinary transactions of business nor to prevent a person from conducting his affairs according to his own judgment. These are broad and general principles. But the courts have found difficulty in applying them to the sweeping terms of the statutes and the decisions, both on account of the varying views of the courts and the varying phraseology of the statutes, are not uniform.

Thus, it is held that an agreement creating an agency for the sale of articles is not a combination in contravention of a State statute, although fixing prices and containing stipulations not to deal with other persons.<sup>1</sup> But a contract whereby a party obtains the exclusive agency for the sale of the goods manufactured by the other party and agrees not to sell any other line of goods has been held to be a contract restricting trade within the meaning of such a statute.<sup>2</sup>

*Comer v. Burton-Lingo Co.*, 24 Tex. Civ. App. 251 (1900), (58 S. W. Rep. 969).

And an agreement between competing hotel proprietors wherein one agreed to close his hotel for hotel purposes for a period of three years and the other agreed to pay him a specified sum monthly during such period has been held to violate the Kentucky statute.

*Clemons v. Meadows* (Ky. 1906), 94 S. W. Rep. 13.

<sup>1</sup> *Welch v. Phelps, etc. Windmill Co.*, 89 Tex. 656 (1896), (36 S. W. Rep. 71): "It was not the purpose of the statute, however, to interpose any obstacle to a principal's contracting with his agent with reference either to the terms or the subject matter of the agency. In the case before us it was entirely within the discretion of the principal, before as well as after the contract was signed, as to how many of its windmills it would send into the named territory,

as well as to decline to sell for less than the net price, or permit its agent to sell for others. It controlled them all, and therefore there was no union or association of otherwise independent, separate and possibly competing 'capital, skill or acts'; and hence no combination."

See also *Weiboldt v. Standard Fashion Co.*, 80 Ill. App. 67 (1899).

<sup>2</sup> *White Dental Mfg. Co. v. Hertzberg* (Tex. Civ. App. 1899), 51 S. W. Rep. 355.

An agreement to assign an outstanding agency contract to a competitor operating in the same territory and to refrain from doing business in such territory is in violation of the Mississippi anti-trust statute.

*Kosciusko Oil Mill, etc. Co. v. Wilson Cotton Oil Co.*, 90 Miss. 551 (1907), (43 So. Rep. 435, 8 L. R. A. (N. S.) 1053).

Where it appeared that a corporation had appointed a general agent

Contracts wherein a manufacturer agrees to confine the sale of his products to a particular dealer in a given territory and the dealer agrees to buy of such manufacturer exclusively are generally held not to violate the State statutes.<sup>1</sup> But such agreements are held to be within the meaning of statutes

and authorized him to establish agencies in a particular territory for the sale of machinery made by different manufacturers which had previously been competitors in such territory, and that such general agent had established the agencies and had bound the local agents under penalties to sell all the machinery at prices fixed by such corporation or general agent, it was held that a trust to fix the price of manufactured articles in violation of the Kentucky statute (see *ante*, § 414, *note*) was shown.

*International Harvester Co. v. Commonwealth* (Ky., 1907), 30 Ky. Law Rep. 716, 99 S. W. Rep. 637.

<sup>1</sup> *Houck v. Wright*, 77 Miss. 483 (1900), (27 So. Rep. 616): "The legislature, by the chapter on trusts and combines, did not intend to debar a person from conducting his own private business according to his own judgment. Indeed, there is no law, federal or State, that requires a person to sell his goods, against his will, to any other person, or to send agents abroad to seek business, or even compel him to employ agents in the conduct of his business. These are matters of private judgment and discretion which belong to every citizen by the laws of nature; they are rights inherent in every freeman, which no human law can rightly supersede or impair."

A contract by which a manufacturer agrees to sell exclusively to a dealer certain machinery to be resold in a particular territory and by which the dealer agrees to purchase exclusively from the manufacturer is not in violation of the South Carolina statute.

*Walter A. Wood Mowing, etc. Co. v. Greenwood Hardware Co.*, 75 S. C. 378 (1906), (55 S. E. Rep. 973).

A contract by a brewing company to sell to one dealer only in a designated territory does not violate the Texas statute.

*Vanderweghe v. American Brewing Co.* (Tex. Civ. App. 1901), 61 S. W. Rep. 526. See also *Norton v. Thomas*, 99 Tex. 578 (1906), (91 S. W. Rep. 780).

An agreement by one corporation to purchase all its raw materials from and sell all its finished product to another corporation is not in conflict with the Illinois statute.

*Heimbucher v. Goff, Horner & Co.*, 119 Ill. App. 373 (1905).

A contract between a manufacturer and a dealer wherein the former agrees to sell its product to the latter at a reduced price in consideration of the latter's agreement not to sell at less than a stipulated price is not in contravention of the New York statute against monopolies.

*Walsh v. Dwight*, 40 App. Div. (N. Y.) 513 (1899), (58 N. Y. Supp. 91). See also *Commonwealth v. Grinstead*, 111 Ky. 203, 1901 (63 S. W. Rep. 427); *Over v. Byram Foundry Co.*, 37 Ind. App. 452 (1906), (77 N. E. Rep. 302).

The grant by a railroad company of the exclusive privilege of soliciting transfer business upon its trains has been held not to contravene the Texas statute.

*Lewis v. Weatherford, etc. R. Co.*, 36 Tex. Civ. App. 48 (1904), (81 S. W. Rep. 111).



specifically declaring void all agreements to limit trade in any article.<sup>1</sup>

An agreement between manufacturers or wholesale dealers not to sell to any person indebted to any party thereto is in conflict with the Missouri statute. It is said to deprive the debtor of the benefit of free competition and to impose a penalty upon his condition.<sup>2</sup> On the other hand, it is broadly held that the right to refuse to maintain trade relations is an inherent right and its exercise not in violation of the New York statute.<sup>3</sup>

An agreement among all the dealers in a certain market limiting their right, under forfeitures and penalties, to buy all the grain on such market they might desire or require is a

<sup>1</sup> *Simmons v. Terry* (Tex. Civ. App. 1904), 79 S. W. Rep. 1103. But see *Norton v. Thomas*, 99 Tex. 578 (1906), (91 S. W. Rep. 780). See also *Troy Buggy Works v. Fife* (Tex. Civ. App. 1903), 74 S. W. Rep. 956; *Texas Brewing Co. v. Templeman*, 90 Tex. 277 (1896), (38 S. W. Rep. 27); *Texas Brewing Co. v. Meyer* (Tex. 1896), 38 S. W. Rep. 262. These decisions of course refer to the Texas statutes.

Compare these decisions with *Lanyon v. Garden City Sand Co.*, 223 Ill. 616 (1906), (79 N. E. Rep. 313, 9 L. R. A. (N. S.) 446), where it was held that an agreement of a manufacturer to sell his product exclusively to the other party who agreed to take it was not in violation of the Illinois statute making it an offence to enter into any contract to limit the quality of any article mined, produced or sold.

Contracts wherein manufacturers and wholesale dealers have granted to retailers exclusive rights for the sale of goods, containing stipulations that the vendor should not permit other persons to handle their products in the designated territory, have also been held to violate the Texas statutes.

*Columbia Carriage Co. v. Hatch*, 19 Tex. Civ. App. 120 (1898), (47 S. W. Rep. 288).

An agreement to purchase salt from a certain corporation for a particular period and not to purchase from other parties or make any importations and "to discourage in every possible manner, any such shipments or importations of salt by other parties" is in violation of the California statute.

*Getz v. Federal Salt Co.*, 147 Cal. 115 (1905), (81 Pac. Rep. 416, 109 Am. St. Rep. 114).

A contract to purchase lambs wherein the purchaser agrees not to buy any other lambs in a designated territory within a prescribed time, is void under the Michigan statute (3 How. Stat. § 9354j) declaring void all contracts designed to restrict free competition in the production or sale of agricultural commodities. *Bingham v. Brands*, 119 Mich. 255 (1899), (77 N. W. Rep. 940).

<sup>2</sup> *Ferd Heim Brewing Co. v. Belinder*, 97 Mo. App. 64 (1903), (71 S. W. Rep. 691).

<sup>3</sup> In the recent case of *Locker v. American Tobacco Co.*, 121 App. Div. (N. Y.) 443 (1907), (106 N. Y. Supp. 115), the Court said: "The complaint evidently proceeds upon the theory that the plaintiffs are vested with the legal right to buy and deal in the

contract in restraint of trade in violation of the Kansas statute.<sup>1</sup>

A contract by a producer to sell to a purchaser all his product except a specified amount, and stipulating that this amount shall not be sold to the trade at a lower price than that at which the purchaser offers the product bought by it, is an agreement to fix the price of a commodity within the prohibition of the Mississippi statute.<sup>2</sup>

The leasing of property to an unlawful combination does not contravene the New York statute against monopolies which is "designed to prevent the owners or controllers of property entering into a combination to regulate production and maintain prices for their mutual benefit according to their respective interests."<sup>3</sup>

**§ 433. Application of Statutes to Particular Associations of Manufacturers and Dealers.** — An association of retail dealers, formed to prevent the competition of wholesale dealers, requiring as a condition of membership that each member continuously carry a fixed amount of stock, and collecting from wholesale dealers a penalty in case they sell directly to con-

merchandise manufactured and controlled by the defendants and to be supplied at all times, as the demands of their customers require, upon complying with the conditions attached to the sale of such products, and paying therefor with such amount thereof as their business demands, and that a refusal to sell to them is a wrongful and actionable invasion of such right; but we are unable to discover in this record anything warranting or sustaining such theory. It is the well settled law of this State that the refusal to maintain trade relations with any individual is an inherent right which every person may exercise lawfully, for reasons he deems sufficient or for no reasons whatever, and it is immaterial whether such refusal is based upon reason or is the result of mere caprice, prejudice or malice. It is a part of the liberty of action which the Constitutions,

State and federal, guarantee to the citizen. It is not within the power of the courts to compel an owner of property to sell or part with his title to it without his consent and against his wishes to any particular person."

See also *Wills v. Central Ice, etc. Co.* (Tex. Civ. App. 1905), 88 S. W. Rep. 265.

<sup>1</sup>*State v. Smiley*, 65 Kan. 240 (1902), (69 Pac. Rep. 199, 67 L. R. A. 903), *affirmed* 196 U. S. 447 (1905), (25 Sup. Ct. Rep. 289).

<sup>2</sup>*Barataria Canning Co. v. Jouliau*, 80 Miss. 555 (1902), (31 So. Rep. 961).

<sup>3</sup>*Brooklyn Distilling Co. v. Standard Distilling Co.*, 120 App. Div. (N. Y.) 237 (1907), (105 N. Y. Supp. 264). See also *Export Lumber Co. v. South Brooklyn Sawmill Co.*, 54 App. Div. (N. Y.) 518 (1900), (67 N. Y. Supp. 626).

sumers or to retail dealers ineligible to membership, is in contravention of the Nebraska anti-trust statute.<sup>1</sup>

An agreement between an association of plumbers and certain manufacturers and dealers, entered into for the purpose of fixing prices and limiting production, wherein the latter agree not to sell supplies to others than members of the association and the former agree to boycott any dealer selling to a non-member, is unlawful under the Missouri statute.<sup>2</sup>

A combination of corporations, effected by means of a series of contracts between each corporation and an intermediary association composed of a member from each of the combining corporations, wherein the several corporations agree to sell all their respective products to such association for a stated period

<sup>1</sup> *Cleland v. Anderson*, 66 Neb. 252 (1902), (92 N. W. Rep. 306): "The provisions of § 1, ch. 91a, Comp. St. 1901, are very broad, and expressly cover any combination of dealers intended 'to prevent others from conducting or carrying on the same business,' or which tend 'to prevent or preclude a free and unrestricted competition among themselves or others or the public generally.' The express object of the association in question is to prevent competition of wholesale dealers in selling directly to contractors and other consumers, and it endeavors not only to prevent this, but to prevent its members from selling in localities where other members are in business, and to prevent wholesalers from selling to dealers who do not carry a stock of 75,000 feet and maintain a permanent yard. These purposes are clearly in contravention of the statute, and, however lawful its other objects, render its acts and the acts of its members, and those who unite with them therein, so far as they are in furtherance of such purposes, unlawful and actionable. A point is made that a large number of dealers in the State are not members, and that the

number of wholesalers who coöperate is relatively small. But the statute meets such a case expressly. It provides that combinations of this nature on the part of 'two or more persons' shall be unlawful, and acts of even a single person, intended to prevent others from engaging in the same business, are prohibited. Hence the number of persons who engage in such combinations, and the proportion they bear to the whole number of dealers in the same trade, are not material."

The early Nebraska statute directed against combinations of grain dealers does not relieve such dealers from the operation of the later statutes declaring illegal *all* combinations in restraint of competition.

*State v. Omaha Elevator Co.*, 75 Neb. 637 (1906), (106 N. W. Rep. 979).

<sup>2</sup> *Walsh v. Association of Plumbers*, 97 Mo. App. 280 (1902), (71 S. W. Rep. 455).

A somewhat similar plumbers' association was held to conflict with the Michigan statute of 1899 in *Hunt v. Riverside Club*, 140 Mich. 538 (1905), (104 N. W. Rep. 40, 112 Am. St. Rep. 420).

and at a stipulated price, is also contrary to the Missouri statute.<sup>1</sup>

On the other hand, a live stock exchange formed to promote the interests of its members was held not to be an illegal combination under the Missouri statute although its by-laws provided that no member should do business with a member who had been suspended or expelled.<sup>2</sup>

The by-laws of an association of local dealers which permit its members to purchase only from such wholesale dealers as will sell to members exclusively contravene the Tennessee statute. Such by-laws are "contracts, arrangements and combinations" calculated to prevent free competition, influence prices and injuriously affect trade and commerce.<sup>3</sup>

An association of commission merchants by means of a corporation the constitution and by-laws of which provide for discriminations in favor of members in the prices to be paid for produce, regulate deliveries, and prescribe penalties against offending members, is a combination interfering with the free purchase and sale of commodities in contravention of the Minnesota statute.<sup>4</sup>

An association of dealers in live stock, a by-law of which forbids members buying or selling for others without charging a minimum commission, has been held to violate the Kansas statute.<sup>5</sup>

An agreement among brewers to raise the price of beer to the extent of a tax imposed thereon is in violation of the Kentucky statute against combinations to fix the price of merchandise or

<sup>1</sup> *Finck v. Schneider Granite Co.*, 187 Mo. 244 (1905), (86 S. W. Rep. 213, 106 Am. St. Rep. 452).

For consideration of the application of the Missouri statute of 1899 prohibiting combinations to fix prices in the case of a "corner" of the market, see *C. H. Albers Commission Co. v. Spencer*, 205 Mo. 105 (1907), (103 S. W. Rep. 523).

<sup>2</sup> *Gladish v. Bridgeford* (Kansas City Ct. of App. 1905), 89 S. W. Rep. 77.

The statutory provision in question (*Missouri Rev. Stat. 1899*, §

8978) was that prohibiting persons engaged in selling any article of commerce from entering into any agreement to limit competition by refusing to buy from, or sell to, another person.

<sup>3</sup> *Bailey v. Master Plumbers' Ass'n*, 103 Tenn. 99 (1899), (52 S. W. Rep. 853, 46 L. R. A. 561).

<sup>4</sup> *Ertz v. Produce Exchange Co.*, 82 Minn. 173 (1901), (84 N. W. Rep. 743, 51 L. R. A. 825).

<sup>5</sup> *State v. Wilson*, 73 Kan. 334 (1906), (84 Pac. Rep. 737).

manufactured articles, notwithstanding it relates to an article the increased use of which is not favored by law.<sup>1</sup>

§ 434. **Application of Statutes to Combinations under Patents and Copyrights.** — The principles which control the application of the federal anti-trust statute to combinations under patents and copyrights govern the application of the State statutes to such combinations and do not require separate examination.<sup>2</sup>

§ 435. **Application of Statutes to Insurance Combinations.** — The anti-trust statutes of several States include, in express terms, combinations of insurance companies designed to prevent competition and maintain rates.<sup>3</sup> In other States, the question has been judicially considered whether such a combination comes within the general provisions of the State statute.

An Iowa statute<sup>4</sup> prohibited the formation of combinations to regulate and fix the price of "oil, lumber, coal . . . or any other commodity." The Supreme Court of Iowa held that

<sup>1</sup> *Commonwealth v. Bavarian Brewing Co.*, 112 Ky. 925 (1902), (66 S. W. Rep. 1016).

<sup>2</sup> See *ante*, § 399: "*Application of Statute to Combinations under Patents*"; § 400: "*Application of Statute to Combinations under Copyrights*."

A corporation organized for the purpose of acquiring patents and granting licenses thereunder, and which has acquired nearly all the patents covering a particular article but which does not bind its licensees as to prices or output, is not in contravention of the Illinois anti-trust statute.

*Columbia Wire Cloth Co. v. Freeman Wire Co.*, 71 Fed. 302 (1895). See also *Clark v. Cyclone Woven Wire Fence Co.*, 22 Tex. Civ. App. 41 (1899), (54 S. W. Rep. 392).

An agreement between publishers representing over ninety per cent of the book trade and controlling over ninety-five per cent of the books published in this country that all future copyrighted books should be sold at retail at certain net prices

and that all other books, whether copyrighted or not, should be sold only to retailers agreeing to maintain prices or to jobbers agreeing not to sell to any blacklisted retailers, while purporting to secure to the publishers the monopoly granted by the copyright law, in effect interferes with the sale of uncopyrighted books and is in violation of the New York anti-monopoly act.

*Strauss v. American Publishers Ass'n*, 177 N. Y. 473 (1904), (69 N. E. Rep. 1107, 101 Am. St. Rep. 819, 64 L. R. A. 701), *affirming* 85 App. Div. (N. Y.) 446 (1903), (83 N. Y. Supp. 271).

<sup>3</sup> The Arkansas statute printed in note to § 414, *ante*, "*The Statutes. Development of State Legislation*," is illustrative.

For construction of the provisions of the Missouri statute relating to insurance companies, see *State v. Firemen's Fund Ins. Co.*, 152 Mo. 1 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363).

<sup>4</sup> McClain's Iowa Code, § 5454.

insurance was a "commodity" within the meaning of this statute, and that a combination of insurance companies was prohibited by its provisions.<sup>1</sup> On the other hand, the Supreme Court of Texas held that the term "commodity," in the Texas statute of 1889, did not include insurance, and that a combination of fire insurance companies to establish uniform rates did not contravene the act.<sup>2</sup> The decision in the Iowa case cannot be regarded as sound. It ignores the *ejusdem generis* rule of construction. The term "commodity," in its broadest sense, may include insurance, but it is not a commodity of the same general class or nature as those commodities previously mentioned in the Iowa statute.

The word "property," as used in the Kentucky anti-trust statute, "does not include the right to enter into a contract of insurance nor to fix the terms upon which such a contract will be made."<sup>3</sup>

Insurance is a "business," the control of which cannot be placed in the hands of trustees, within the meaning of the Mississippi statute.<sup>4</sup>

<sup>1</sup> *Beechley v. Mulville*, 102 Iowa, 602 (1897), (70 N. W. Rep. 107, 63 Am. St. Rep. 479).

The word "trade" in the title of an act fairly includes the provisions of the act concerning insurance, and such an act is valid in a State where the subject of an act must be clearly expressed by its title.

*In re Pinkney*, 47 Kan. 89 (1891), (27 Pac. Rep. 179). See also *State v. Phipps*, 50 Kan. 609 (1893), 31 Pac. Rep. 1097, 34 Am. St. Rep. 152, 18 L. R. A. 657).

<sup>2</sup> *Queen Ins. Co. v. State*, 86 Tex. 250 (1893), (24 S. W. Rep. 397, 22 L. R. A. 483). To meet this decision the word "business" was inserted in the Texas act of 1895.

<sup>3</sup> *Ætna Ins. Co. v. Commonwealth*, 106 Ky. 864 (1899), (21 Ky. Law Rep. 503, 51 S. W. Rep. 624): "While it may be admitted that a contract, either for labor or for indemnity against contingent loss, like an insurance contract, when executed, becomes

property, because it is then a *chose in action*, the right to enter into such contracts, which belongs to all persons capable of contracting — as well natural persons as artificial ones authorized by their organic law to make such contracts — would hardly be considered to be included in the word 'property,' unless that word were used in a much broader sense than it is customarily used by lawyers or in statutes."

<sup>4</sup> *American Fire Ins. Co. v. State*, 75 Miss. 24 (1897), (22 So. Rep. 99): "It [the statute] prohibits any trust the object of which is to place the control of business (any business) to any extent in the power of trustees. The law-makers wisely refrained from any specification of, or attempt to enumerate, the kinds of business whose control should thus be placed in the power of trustees, for the obvious reason that such kinds of business in modern life are multiform. It, therefore, prohibited any trust

Contracts of insurance issued by a foreign insurance company upon property within a State do not constitute interstate commerce, and State statutes against combinations may apply to foreign insurance companies combining to increase local rates, and when so applying are, as shown in the next section, within the appropriate scope of State legislation.<sup>1</sup>

§ 436. **Application of Statutes to Foreign Corporations doing Local Business.** — A corporation created by the laws of one State has no absolute right to transact business beyond its borders. Its privileges in other States are permissive and depend upon the comity between States. A State, in admitting foreign corporations, may impose any conditions, reasonable or unreasonable, which it deems expedient.<sup>2</sup>

A foreign corporation doing business in a State is subject to its general laws and regulations. It cannot exercise, within the State, powers prohibited in the case of corporations generally. Statutes against combinations of corporations apply to

whose object was to place the control of any business in the power of trustees, when the effect of such trust should be to injure the public or any particular person or corporation in this State. Such legislation has become very general in the United States owing to the pernicious results of such trusts."

<sup>1</sup> *State v. Phipps*, 50 Kan. 615 (1893), (31 Pac. Rep. 1097, 34 Am. St. Rep. 152, 18 L. R. A. 657): "It is a conclusive presumption of the law that this court knew that the legislature of this State had no power to regulate interstate commerce, and the presumption is equally strong and conclusive, that by the use of the word 'trade' the intercourse between citizens of different States, that constitutes interstate commerce, was not in contemplation. It has been judicially determined, time and time again, by the highest judicial authority in the land, that issuing a policy of insurance is not a transaction of commerce."

In holding the Iowa statute (Code

1897, § 1754) prohibiting particularly combinations of insurance companies constitutional, the Supreme Court of the United States in *Carrol v. Greenwich Ins. Co.*, 199 U. S. 401, 411 (1905), (26 Sup. Ct. Rep. 66) said: "If the legislature of the State of Iowa deems it desirable artificially to prevent, so far as it can, the substitution of combination for competition, this court cannot say that fire insurance may not present so conspicuous an example of what that legislature thinks an evil as to justify special treatment."

<sup>2</sup> *Hartford Fire Ins. Co. v. Raymond*, 70 Mich. 501 (1888), (38 N. W. Rep. 474): "It has been repeatedly held, . . . that corporations of one State have no right to exercise their franchises in another State except upon the assent of such other State, and upon such terms as may be imposed by the State where their business is to be done. The conditions imposed may be reasonable or unreasonable; they are absolutely within the discretion of the legislature."

foreign as well as domestic corporations. Foreign corporations violating their provisions may be ousted from the State.<sup>1</sup>

<sup>1</sup> *United States*: *Waters-Pierce Oil Co. v. Texas*, 177 U. S. 28 (1900), (20 Sup. Ct. Rep. 518).

*Illinois*: *Harding v. American Glucose Co.*, 182 Ill. 551 (1899), (55 N. E. Rep. 577, 74 Am. St. Rep. 189, 64 L. R. A. 738). See also *Bishop v. American Preservers Co.*, 157 Ill. 284 (1895), (41 N. E. Rep. 765, 48 Am. St. Rep. 317); *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770).

*Kansas*: *State v. Phipps*, 50 Kan. 619 (1893), (31 Pac. Rep. 1097, 34 Am. St. Rep. 152, 18 L. R. A. 657): "The State has power to regulate and control, and to provide penalties for the transgression of its regulating and controlling statutes, the business of a foreign insurance company within its borders."

*Michigan*: The anti-trust statute of this State in providing in case of the violation of its provisions by a foreign corporation for the revocation of the certificate of such corporation, upon which its right to do business in the State depends, is not in contravention of the Fourteenth Amendment as abridging the privileges or immunities of citizens of the United States.

*Attorney-General v. A. Booth & Co.*, 143 Mich. 89 (1905), (106 N. W. Rep. 868). See also *ante*, § 421.

*Missouri*: *National Lead Co. v. Grote Paint Store Co.*, 80 Mo. App. 247 (1899): "Neither can the plaintiff shut off an investigation of its corporate organization and purpose upon the plea of comity due it as a foreign corporation. The doctrine on this subject is simple and clear. It concedes no rights to a corporation of a sister State which are denied by law to a domestic corporation, or which are contrary to the laws or public policy of the State into which

the foreign corporation enters for business." See also *State v. Firemen's Fund Ins. Co.*, 152 Mo. 1 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363).

A State may impose such conditions as it may deem expedient upon the privilege of foreign corporations to do business therein so long as it does not interfere with interstate commerce or invade some other federal right.

*State v. Standard Oil Co.*, 194 Mo. 124 (1906), (91 S. W. Rep. 1062).

*Nebraska*: *State v. Standard Oil Co.*, 61 Neb. 28 (1901), (84 N. W. Rep. 413).

*South Carolina*: A foreign corporation accepting the privilege to do business within a State upon the same conditions as domestic corporations is not deprived of any constitutional rights by a statute which deprives it of such privilege in case it violates an anti-trust statute.

*State v. Virginia-Carolina Chemical Co.*, 71 S. C. 544 (1904), (51 S. E. Rep. 455).

*Tennessee*: *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 1039, 78 Am. St. Rep. 941). See also *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015).

*Texas*: *Waters-Pierce Oil Co. v. State*, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 936). See also *Waters-Pierce Oil Co. v. State* (Tex. Civ. App. 1908), 106 S. W. Rep. 918; *National Cotton Oil Co. v. State* (Tex. Civ. App. 1903), 72 S. W. Rep. 615.

That foreign corporations may attack constitutionality of State anti-trust statute, see *Niagara Fire Ins. Co. v. Cornell*, 110 Fed. 816 (1901). See also *Carrol v. Greenwich Ins. Co.*, 199 U. S. 401 (1905), (26 Sup. Ct. Rep. 66).



In *Waters-Pierce Oil Co. v. Texas*,<sup>1</sup> the Supreme Court of the United States, in holding that a Texas anti-trust statute applied to foreign corporations, and that their privilege of transacting business within the State might be forfeited for disobeying it, said: "The plaintiff in error is a foreign corporation, and what right of contracting has it in the State of Texas? This is the only inquiry, and it can only find an answer in the rights of corporations and the power of the State over them. What those rights are and what that power is has often been declared by this court. A corporation is the creature of the law, and none of its powers are original. They are precisely what the incorporating act has made them, and can only be exerted in the manner which that act authorizes. In other words, the State prescribes the purposes of a corporation and the means of executing those purposes. Purposes and means are within the State's control. This is true as to domestic corporations. It has even a broader application to foreign corporations. . . . A contract of the corporation is the contract of the legal entity, and not of its individual members. Its rights are those given to it in that character, and not the rights which belong to its constituent citizens. Its charter confers its powers and the means of executing them, and such powers and means can only be exercised in other States by the permission of the latter."

The greater power of wholly excluding from a State foreign corporations contravening its laws or policy includes the power, when such a corporation is formed for the purpose of controlling a domestic corporation in violation of an anti-trust statute, to enjoin it from doing any act in furtherance of such purpose.<sup>2</sup>

§ 437. **Statutes have no Extraterritorial Force.** — The penal statutes of a State have no binding effect outside its borders. A law attempting to make criminal, acts done without the State is void.<sup>3</sup> The State may, however, make criminal and unlawful

<sup>1</sup> *Waters-Pierce Oil Co. v. Texas*, 177 U. S. 43 (1900), (20 Sup. Ct. Rep. 518).

<sup>2</sup> *Southern Electric Sec. Co. v. State* (Miss. 1907), 44 So. Rep. 785.

<sup>3</sup> *In re Grice*, 79 Fed. 638 (1897):

"The fifth paragraph of the said act, in which it is attempted to claim jurisdiction for offences committed outside of the State of Texas, is so absurd that a denial thereof is scarcely necessary. . . . It has been properly

the carrying into effect within its limits of a combination entered into without.

In the construction of an anti-trust statute, it will be presumed that the legislature recognized these elementary principles, and intended "that its statutes should not apply to acts or contracts done or effected beyond the limits of the State, and having no reference to or effect upon persons or property in this State."<sup>1</sup>

Upon these principles it follows that while a State has no extraterritorial jurisdiction and cannot reach offences committed outside its borders, it has power to deal with offences put in motion in a foreign State but carried into execution within its limits. Thus a foreign corporation doing business in a State which becomes a member of a combination outside the State to fix the prices of property therein violates a State statute prohibiting combinations to fix prices.<sup>2</sup>

suggested that, should this feature of this act be carried out and administered, it would be unnecessary for any other State or the nation at large to have any other laws upon the subject, as all persons within the limits of the United States could be regulated in their dealings and in the conduct of their business according to the wishes of the legislature of Texas. The State, in its criminal jurisdiction as to acts committed within its own boundaries, and within the limits prescribed by the federal Constitution, is sovereign, and its process should not be interfered with where it does not contravene the said Constitution; but, beyond the boundaries of the State, it has no more authority in New York, Missouri, or Ohio than it has in Great Britain or Austria, and that part of the act which proposes this extraterritorial jurisdiction is absolutely null and void."

See also *State v. Associated Press*, 159 Mo. 410 (1901), (60 S. W. Rep. 91, 81 Am. St. Rep. 368, 51 L. R. A. 151).

<sup>1</sup> *State v. Lancashire Fire Ins. Co.*,

66 Ark. 472 (1899), (51 S. W. Rep. 633, 45 L. R. A. 348), (*per* Riddick, J.). See also *State v. Aetna Fire Ins. Co.*, 66 Ark. 480 (1899), (51 S. W. Rep. 638).

<sup>2</sup> *International Harvester Co. v. Commonwealth* (Ky. 1907), 30 Ky. Law Rep. 716, 99 S. W. Rep. 637. In this case the Court said: "The legislature has no extraterritorial power to punish crime. The crime specified in the statute is the entering into, becoming a member of, or a party to, any pool, trust, etc., to fix the prices at which property may be sold in this State. If a foreign corporation doing business in this State enters into or becomes a member of a pool or trust beyond the limits of this State, then the crime is clearly committed beyond the limits of this State, unless the pool or trust is to fix the prices of property in this State, in which event the crime put in motion in the foreign State took effect and became complete in Kentucky."

See also *Waters-Pierce Oil Co. v. State* (Tex. Civ. App. 1908), 106 S. W. Rep. 918.

§ 438. **Application of Statutes to Agreements of Quasi-public Corporations.** — An agreement between the gas and electric lighting corporations of a city, the effect of which is to practically place them under one management, divide public contracts, and eliminate competition, is in violation of the Texas statute.<sup>1</sup>

A practical consolidation of electric companies for the purpose of eliminating competition, effected by means of a foreign holding corporation, is in conflict with the Mississippi statute.<sup>2</sup>

An agreement between a gas company and a coal company wherein the former agrees to sell to the latter exclusively all its coke — a by-product — is not in conflict with the Minnesota statute. By-products stand in a different position from the gas or electricity which a public service corporation is bound to furnish to all alike.<sup>3</sup>

A contract between a railroad company and a sleeping car company giving the latter the exclusive right to run its cars upon the railroad for a stated period is not in conflict with the Texas statute. Sleeping car companies have no right to run their cars upon railroads except under arrangements with the railroad companies. "Since no such business right existed it could not be restricted."<sup>4</sup>

An agreement by railroad companies to make specially low

<sup>1</sup> *San Antonio Gas Co. v. State*, 22 Tex. Civ. App. 118 (1899), (54 S. W. Rep. 289).

<sup>2</sup> *Southern Electric Sec. Co. v. State* (Miss. 1907), 44 So. Rep. 786. See also *ante*, § 428.

<sup>3</sup> *State v. St. Paul Gaslight Co.*, 92 Minn. 470 (1904), (100 N. W. Rep. 216): "A distinction must be made between a corporation engaged in a particular line of business, which enters into a combination to dispose of all of its products to a competitor for the purpose of enabling the competitor to fix prices and control the markets, and one situated as defendant, which, in the course of its principal business, accumulates incidentally thereto a by-product or commodity in which it does not deal. It is unimportant that the gas-light company is a public service

corporation; the rule remains the same."

<sup>4</sup> *Fort Worth, etc. R. Co. v. State* (Tex. 1905), 87 S. W. Rep. 336, 70 L. R. A. 950.

An agreement between a railroad company and an express company whereby the latter is granted exclusive privileges upon the railroad of the former, and is protected in the contingency that the railroad company should be required by law to accord similar privileges to other express companies, is in violation of the Texas anti-trust statute, which is not rendered inapplicable by the fact that the railroad commission of that State has power to regulate the rates of both railroad and express companies.

*State v. Missouri, etc. R. Co.*, 99 Tex. 516 (1906), (91 S. W. Rep. 214).

rates for non-transferable excursion tickets from a certain city is not in violation of the Texas statutes, there being no agreement to restrain competition in the sale of such tickets.<sup>1</sup>

A car-service association organized by railroad companies for the purpose of securing the prompt and just assessment of demurrage for the detention of cars is not unlawful under the provisions of the Mississippi statute forbidding the placing of the control of the business of corporations in the hands of trustees or persons other than their officers and agents.<sup>2</sup>

§ 439. **Effect of Statutes upon Exercise of Statutory Authority to consolidate or hold Stock.** — Statutes authorizing corporations to consolidate or to hold shares in other corporations in themselves define the policy of the State upon such subjects. The exercise of the power conferred could not be held invalid upon any principle of the common law. But it does not necessarily follow that it could be exercised in contravention of a State statute forbidding combinations.

Under such conditions, in the case of private corporations, the statute which applied the more specifically would control. Thus, for example, if a particular combination were expressly authorized it would undoubtedly be held valid notwithstanding it might conflict with an anti-trust statute. And, on the other hand, a consolidation under a general statute would probably not be upheld if clearly contrary to the specific provisions of a statute against combinations. The latter statute would be treated as limiting the powers conferred by the former.

These principles also apply to *quasi*-public corporations subject to the additional principle that the State has, in the case of such corporations, full power to protect itself against increases in charges. A union of public utility corporations, either by strict consolidation or through corporate stockholding, when authorized by law, could hardly be said to constitute a combination to increase charges in violation of an anti-trust statute although embracing all the corporations in a particular territory and although designed to prevent competition.<sup>3</sup> The

<sup>1</sup> *Lytle v. Galveston, etc. R. Co.* (Tex. 1907), 99 S. W. Rep. 396.

<sup>2</sup> *Yazoo, etc. R. Co. v. Searles*, 85 Miss. 520 (1905), (37 So. Rep. 939, 68 L. R. A. 715).

<sup>3</sup> In *In re Consolidated Gas Co.*, 124 App. Div. (N. Y.) 401 (1908), (108 N. Y. Supp. 823), *affirming* 56 Misc. 49 (1907), (106 N. Y. Supp. 407), it was held that the consolidation, under

legislature would have full power over the situation for the protection of the public. Probably only a statute applying

statutory authority, of six gas companies and the subsequent purchase by the consolidated company, under like authority, of all, or controlling interests in, the shares of other similar corporations in order to prevent competition did not create a monopoly in violation of the New York statute. The Court said: "What is prohibited is the creation of a monopoly, and establishing such a competition as will result in limiting the supply and enhancing the cost of the commodity dealt in. In no sense can the consolidation of the lighting companies in the City of New York into a single corporation be said to create such a monopoly, for it gains thereby no exclusive right, the field is still open to any other company that can obtain the necessary consents from the constituted authorities, and neither the production nor the price can be arbitrarily fixed by the Consolidated Company. In this respect there is a very clear distinction between a company supplying gas or electricity and a corporation or combination of producers who deal in ice, envelopes, bluestone, milk, sheep and lambs, coal and lard, as to all of which our courts have condemned combinations organized for the purpose of controlling output and fixing prices. . . . In the case of the Consolidated Gas Company it cannot, as a result of its control of the business of furnishing light, either limit production or increase prices and maintain them, because both of those matters are within the control of the Legislature. It is within the power of that body, and it has frequently used the power, to fix the maximum rate which may be charged to consumers, and it is well settled that any person within the territory served by a gas or electric light company is entitled to be fur-

nished with such gas or electricity as he require upon payment of the statutory price therefor, and can compel the company so to furnish it. That a single company, thus regulated by law as to price and production, does not offend against the anti-monopoly laws, even although its field of operation extends over a whole city, seems to be quite clear.

We are, therefore, of the opinion that the organization of the Consolidated Gas Company of New York, under the provision of ch. 367 of the Laws of 1884 was lawful and valid, and its subsequent purchase of the stock of the companies named in the petition was authorized by § 40 of the Stock Corporation Law, and that neither by the organization of the company nor by its purchase of the stock of other companies was an unlawful monopoly created within the meaning of § 7 of the Stock Corporation Law or of the Anti-Monopoly Act of 1899."

*Compare*, however, *Burrows v. Interborough-Metropolitan Co.*, 156 Fed. 389 (1907), where it was held that the acquisition by a holding corporation of controlling stock interests in all the street railway lines in the boroughs of Manhattan and the Bronx in New York City, although in the exercise of statutory authority to purchase shares, was invalid as creating a monopoly in violation of the New York statutes. Judge Holt said: "There may be many cases in which it is desirable and in all respects unobjectionable for a corporation to purchase and hold some of the stock of another corporation; and it would have been perfectly consistent for the Legislature to have tacked § 7 on to § 40 as a proviso. I think that is the true construction of the legislative meaning as shown by the statute.

specifically to *quasi*-public corporations would curtail the power to consolidate or purchase shares conferred upon them by other statutes.

§ 440. **Statutes Inapplicable to Contracts with State.** — Contracts in which a contractor agrees to furnish for the use of the State articles below the normal cost of production do not contravene the Mississippi statute. A public contract for an article below cost cannot be said to be "inimical to the public welfare."<sup>1</sup>

§ 441. **Statutes Inapplicable where Other Statutes eliminate Competition.** — State statutes for the preservation of competition are inapplicable where other statutes eliminate the possibility of there being competition. Thus the purchase by a corporation engaged in the business of compressing cotton of other compress plants is not in contravention of an anti-trust statute where the price for compressing is the same throughout the State — being regulated by a commission — and where the laws require cotton to be compressed at the nearest press.<sup>2</sup>

§ 442. **Statutes do not supersede Common Law.** — The inadequacy of the common law remedy of merely refusing to enforce contracts contrary to public policy lead to the present anti-trust legislation.<sup>3</sup> But while the statutes generally embrace all

Corporations were authorized by it to purchase, acquire, and hold the stocks of other corporations, provided they did not thereby combine for the creation of a monopoly or the unlawful restraint of trade, or for the prevention of competition in any necessary of life. So long as such acquisition did not create a monopoly, or restrain trade, or prevent competition in any necessary of life, such a purchase was lawful; as soon as it did, it became unlawful."

In *In re Interborough-Metropolitan Co.*, 56 Misc. Rep. (N. Y.) 128 (1907), (106 N. Y. Supp. 416), the New York Supreme Court followed *In re Consolidated Gas Co.*, *supra*, and, upon the same facts, declined to follow the decision of Judge Holt.

See also *Rafferty v. Buffalo City Gas Co.*, 37 App. Div. (N. Y.) 622 (1899), (56 N. Y. Supp. 288).

<sup>1</sup> *Johnson Pub. Co. v. Mills*, 79 Miss. 543 (1902), (31 So. Rep. 101).

For consideration of the question whether statutes authorizing boards of education to enter into contracts for the exclusive use of school books contravene constitutional provisions against monopolies, see *Rand, McNally & Co. v. Hartranft*, 29 Wash. 591 (1902), (70 Pac. Rep. 77); *Leeper v. State*, 103 Tenn. 500 (1899), (53 S. W. Rep. 962, 48 L. R. A. 167). See also *Dickinson v. Cunningham*, 140 Ala. 527 (1903), (37 So. Rep. 345).

<sup>2</sup> *State v. Shippers Compress, etc. Co.*, 95 Tex. 603 (1902), (69 S. W. Rep. 58, 93 Am. St. Rep. 870, 58 L. R. A. 714).

<sup>3</sup> *State v. Firemen's Fund Ins. Co.*, 152 Mo. 42 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363): "But the common law remedy of refusing to enforce such contracts proved insufficient to

contracts and combinations contrary to the rules of public policy — and go much farther — they do not, unless expressly so providing, supersede the common law. They supplement and add to, but do not abrogate, it.<sup>1</sup>

Conversely, no right to recover a penalty prescribed in an anti-trust statute can be based upon the ground that the contract, in addition to violating the statute, creates a monopoly at common law.<sup>2</sup>

§ 443. **Statutes not Retroactive, but apply to Continuing Combinations.** — An act making it unlawful for a corporation to enter into a combination for certain purposes, and imposing penalties for its violation, is not retroactive and does not deprive a corporation, infringing its provisions, of the right to enforce its antecedent contracts.<sup>3</sup> And, in general, an anti-trust statute cannot affect contracts entered into and executed before its enactment. Otherwise it would be unconstitutional as impairing the obligation of contracts.<sup>4</sup>

The object of anti-trust statutes, however, is to eliminate combinations of the character prohibited, and, while not retroactive, the effect of their enactment, as a general rule, is to prevent the continuance of combinations of that nature which may be in existence, as well as the formation of new ones.<sup>5</sup>

prevent the blighting injuries to the public interests which modern trusts produced, and hence it has been found necessary by the national and State legislatures to enact stringent laws against trusts, pools, unlawful combinations and conspiracies which will prevent them, and not leave them to exist and enforce their contracts among themselves, denying them only the aid of the courts, as at common law."

<sup>1</sup> *People v. Aachen, etc. Fire Ins. Co.*, 126 Ill. App. 636 (1906). See also *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770).

<sup>2</sup> *Missouri, etc. R. Co. v. Sisson* (Tex. Civ. App. 1905), 88 S. W. Rep. 371.

<sup>3</sup> *Sterling Remedy Co. v. Wyckoff*, 154 Ind. 437 (1900), (56 N. E. Rep. 911).

<sup>4</sup> *Crump v. Ligon* (Tex. Civ. App. 1904), 84 S. W. Rep. 250.

<sup>5</sup> *Matter of Davies*, 168 N. Y. 89 (1901), (61 N. E. Rep. 118, 56 L. R. A. 855).

*State v. Missouri, etc. R. Co.* (Tex. 1906), 91 S. W. Rep. 219: "The State may, in the exercise of its police power, prohibit the continuance in the future of those things already in existence which are so injurious to the rights and interests of its citizens generally as to justify such an exercise of the power whether the continuance of the things is provided for by contract or not."

A State anti-trust statute is not retroactive, but it prohibits both the continuance in business and the engaging in business in violation of its provisions. *State v. Jack*, 69 Kan. 387 (1904), (76 Pac. Rep. 911),

The offence is rather in persisting in the combination than in entering into it.

Moreover, where a contract is a continuing one a statute which declares it unlawful has no retroactive effect. If it results in an unlawful combination or monopoly after the adoption of the statute, it may be reached by the statute acting prospectively although it was entered into before its enactment.<sup>1</sup>

§ 444. **Construction and Application of Miscellaneous Statutes.**—The New York statute<sup>2</sup> against combinations is disjunctive, and prohibits corporations from combining to accomplish three things: (1) the “creation of a monopoly”; (2) “the unlawful restraint of trade”; or (3) “the prevention of competition in any necessary of life.”<sup>3</sup> In making such prohibitions the statute “is little more than a codification of the common law upon the subject.”<sup>4</sup>

The Minnesota statute<sup>5</sup> follows substantially the language of the federal anti-trust statute and should receive a similar construction.<sup>6</sup>

A broad provision in the Texas statute of 1899 that it should be held to be cumulative of all the laws upon the subject did

*affirmed* 199 U. S. 372 (1905), (26 Sup. Ct. Rep. 73).

*Ford v. Chicago Milk Shippers' Ass'n*, 155 Ill. 166 (1895), (39 N. E. Rep. 651, 27 L. R. A. 298): “The corporation is subject to the statute and although the contract of guaranty was entered into before the passage of the act, yet by its terms the furnishing of the commodity named, from month to month, was contemplated, and by the facts as found by the appellate court that for which the price is sought to be recovered in this case was furnished after the passage of the act. The acts of the corporation and its stockholders with reference to this sale were within the meaning of the act.”

See also *ante*, § 404: “*Statute (Federal) not Retroactive but applies to Continuing Combinations.*”

<sup>1</sup> *Finck v. Schneider Granite Co.*, 187 Mo. 244 (1905), (86 S. W. Rep. 213, 106 Am. St. Rep. 452).

<sup>2</sup> *New York Laws of 1897*, ch. 384, § 7.

<sup>3</sup> *National Harrow Co. v. Bement*, 21 App. Div. (N. Y.) 290 (1897), (47 N. Y. Supp. 462).

<sup>4</sup> *Matter of Davies*, 168 N. Y. 89 (1901), (61 N. E. Rep. 118, 56 L. R. A. 855). The statute, however, in imposing penalties goes farther than the common law.

<sup>5</sup> *Minnesota Laws 1899*, p. 487, ch. 359.

<sup>6</sup> *Minnesota v. Northern Securities Co.*, 123 Fed. 692 (1903). The decision in this case was, however, reversed by the Supreme Court upon the ground that the case had been improperly removed from the State court. 194 U. S. 48 (1903), (24 Sup. Ct. Rep. 589).



not incorporate in it the unconstitutional class exemption of an earlier law and thus render it itself unconstitutional.<sup>1</sup>

Where an oil company in order to procure the countermand of an order given by a merchant to a competitor presented a quantity of oil to the merchant, it was held that both the oil company and the merchant were engaged in a conspiracy to lessen competition within the meaning of the Tennessee statute.<sup>2</sup>

A Nebraska statute<sup>3</sup> forbidding combinations entered into by persons "engaged in manufacturing, selling or dealing in the same or any like manufactured or natural products," does not apply to persons engaged in the laundry business.<sup>4</sup>

The Indiana statute<sup>5</sup> declares that contracts designed or tending to affect prices entered into by persons or corporations who "control the output" of merchandise shall be void. The phrase "control the output" in the act is given a broad interpretation. It is said that a limited number of firms cannot control the output of an article which can be made in any foundry, and that the statute does not apply to those who merely control the output of a single town or factory.<sup>6</sup>

The Illinois anti-trust statute did not repeal a previously existing general conspiracy statute — there being no repugnancy between the acts — and both enactments are in force.<sup>7</sup> The Kansas statute of 1891 prohibiting combinations among dealers in live stock was, however, superseded by the later general anti-trust act.<sup>8</sup>

The contracts and combinations declared unlawful and

<sup>1</sup> *State v. Laredo Ice Co.*, 96 Tex. 461 (1903), (73 S. W. Rep. 951).

<sup>2</sup> *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 706, 10 L. R. A. (N. S.) 1015). The statute in question was *Tennessee Acts 1903*, p. 268, ch. 140. See *ante*, § 414.

<sup>3</sup> *Nebraska Sess. Laws 1889*, ch. 69.

<sup>4</sup> *Downing v. Lewis*, 56 Neb. 386 (1898), (74 N. W. Rep. 900).

<sup>5</sup> *Indiana Anno. Stat. 1901*, § 3312g.

<sup>6</sup> *Over v. Byram Foundry Co.*, 37 Ind. App. 452 (1906), (77 N. E. Rep. 302).

<sup>7</sup> *Sanford v. People*, 121 Ill. App. 619 (1905).

A combination between several independent newspaper concerns to compel another concern to reduce rates for advertising or lose customers is indicative of a malicious purpose and is in contravention of a Wisconsin statute against combinations to maliciously injure the business of another.

*State v. Huegin*, 110 Wis. 189 (1901), (85 N. W. Rep. 1046).

<sup>8</sup> *State v. Wilson*, 73 Kan. 334 (1906), (84 Pac. Rep. 737).

void by the South Carolina statute<sup>1</sup> are only those made with a view to lessen, or which tend to lessen, competition to an unreasonable degree.<sup>2</sup>

The provision in the Arkansas statute<sup>3</sup> requiring the Secretary of State to send yearly to each corporation in the State a letter of inquiry as to whether it has any interest in any unlawful trust or combination, to be answered under oath by an officer of the corporation, but not expressly requiring the corporation to answer or making the failure of the officers to answer an offence, does not create an offence and the mere failure to answer does not constitute a violation of the act.<sup>4</sup>

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## CHAPTER XLIII

### RIGHTS, REMEDIES, AND PROCEDURE UNDER STATE ANTI-TRUST STATUTES

- § 445. Contracts in Violation of Statutes Unenforceable. Independent Contracts. Invalidity under Statutes as Ground of Collateral Attack.
- § 446. Criminal Proceedings. Indictments.
- § 447. Proceedings to enforce Forfeitures.
- § 448. Proceedings against Corporations.
- § 449. Actions for Damages.
- § 450. Evidence. Production of Books.
- § 451. Statutes of Limitation.

§ 445. **Contracts in Violation of Statutes Unenforceable. Independent Contracts. Invalidity under Statutes as Ground of Collateral Attack.** — The State anti-trust statutes, as a general rule, contain a provision that any contract in violation thereof shall be void and shall not be enforced in law or equity.<sup>5</sup> And

<sup>1</sup> *South Carolina Code* 1902, § 2845.

<sup>2</sup> *State v. Virginia-Carolina Chemical Co.*, 71 S. C. 544 (1904), (51 S. E. Rep. 455).

<sup>3</sup> *Acts* 1905, p. 6, § 7.

<sup>4</sup> *State v. International Harvester Co.*, 79 Ark. 517 (1906), (96 S. W. Rep. 119).

<sup>5</sup> Under a statute declaring void all contracts designed or tending to lessen

free competition in the manufacture or sale of any article, an agreement with subscribers to stock in a corporation which was designed to monopolize the dairy business of a certain territory was held to be invalid and unenforceable. The Court said: "If the plaintiff entered into a combination with subscribers to the stock in the contemplated association with

without such express provision any such contract would be unenforceable. An agreement in violation of a statute has no validity.

A provision in a contract in violation of a State anti-trust act is not only void itself but, when not severable, taints the contract as a whole, and all the other provisions of it, and renders them unenforceable.<sup>1</sup> But upon the principles considered with respect to illegal combinations in general,<sup>2</sup> and combinations in violation of the federal statute in particular,<sup>3</sup> the fact that one of the parties to an *independent* contract is a member of, or is, itself, a combination in violation of a State anti-trust statute, cannot be set up as a defence to an action brought upon the contract. In the absence of express statutory provision, the validity of a combination must be tested in direct proceedings. Buyers from a combination cannot avoid paying their debts by showing its illegality unless a statute authorize such procedure.<sup>4</sup>

the purpose and intent to lessen full and free competition in the production and sale of articles, products and commodities to be bought, handled and manufactured by such contemplated association, the contract was void."

Hastings Industrial Co. v. Baxter, 125 Mo. App. 494 (1907), (102 S. W. Rep. 1075).

<sup>1</sup> Getz Bros. & Co. v. Federal Salt Co., 147 Cal. 115 (1905), (81 Pac. Rep. 416, 109 Am. St. Rep. 114).

Where two notes and a mortgage securing them were given for a consideration, a part of which, and less than either of the notes, was based upon a transaction contrary to an anti-trust statute, it was held that both of the notes and the mortgage were void. *State v. Wilson*, 73 Kan. 334 (1906), (84 Pac. Rep. 737).

In this case the Court said: "A part of the consideration of the mortgage was, therefore, illegal, if the facts were as the defendant attempted to show. Would this render the mortgage itself void? The generally accepted rule is that if any part of a

single consideration or either of two separate considerations of a contract is illegal the entire contract is void, although where two promises, one of which is illegal, are made upon a lawful consideration, the promise which is unobjectionable is ordinarily held to be enforceable. . . . Where one of two considerations or a distinct part of one consideration is unlawful as being forbidden either by the statute or by the common law the prevailing view is that the partial illegality taints the entire transaction and the contract itself is void."

<sup>2</sup> See *ante*, § 369: "Collateral Attack upon Combination. Remedies upon Independent Contracts."

<sup>3</sup> See *ante*, § 405: "Invalidity under Federal Statute as a Ground of Collateral Attack."

<sup>4</sup> A lease of a distillery to a corporation organized to create a monopoly in violation of a State anti-trust statute is not invalid even if the lessor know the purposes of the corporation. In so holding the Court, in *Brooklyn Distilling Co. v. Standard Distilling Co.*, 120 App. Div. (N. Y.)

In several States, however, the anti-trust statutes provide that purchasers of goods from a combination, formed in violation of their provisions, shall not be liable for the purchase price, and may plead the statute as a defence to any action therefor.<sup>1</sup> The difficulties attending the application of such statutes and the possibility of conflicting adjudications are obvious; but it is not perceived upon what ground they can be declared unconstitutional.<sup>2</sup> Certainly, the obstacles in the way of the prac-

237 (1907), (105 N. Y. Supp. 264), said: "It must be borne in mind that the plaintiff in making the lease did not in any way become a party to the illegal combination or participate to any extent in any scheme to avoid the statute by controlling the manufacture or sale of the commodity referred to. The lease was the only contract which it made with the defendant. It could just as well be contended that a contractor who had built the distillery for the defendant with knowledge of its purpose was not entitled to recover the contract price, or that a farmer who had sold his corn to the defendant knowing its purpose in buying it, could not recover the price agreed to be paid, as it can that the plaintiff is not entitled to recover in this action. The plaintiff, as we have already seen, took no part in the illegal combination; could derive no benefit from it or from the incorporation of the defendant or the carrying out of its purpose; had nothing to do with regulating the quantity of alcohol and spirituous liquors to be produced, or the price to be charged, and, therefore, the contract is clearly distinguishable from those where premises are leased to be used for immoral purposes."

See also *Harrison v. Glucose Sugar Ref'g Co.*, 116 Fed. 304 (1902), (58 L. R. A. 915); *National Salt Co. v. Ingraham*, 143 Fed. 805 (1906); *Chicago Wall Paper Mills v. General Paper Co.*, 147 Fed. 491 (1906).

<sup>1</sup> The Illinois statute is illustrative (Act of June 11, 1891): "Any purchaser of any article or commodity from any individual, company or corporation transacting business contrary to any provision of the preceding sections of this act shall not be liable for the price or payment of such article or commodity and may plead this act as a defence to any suit for such price or payment."

See also anti-trust statutes of Iowa, Kansas, Kentucky, Missouri, Nebraska, North Dakota and Texas, referred to in note to § 414, *ante*: "*The Statutes. Development of State Legislation.*"

<sup>2</sup> The statutes have been pleaded and the defences sustained as valid in *National Lead Co. v. Grote Paint Store Co.*, 80 Mo. App. 247 (1899); *Ford v. Chicago Milk Shippers' Ass'n*, 155 Ill. 166 (1895), (39 N. E. Rep. 651, 27 L. R. A. 298). See also *American Strawboard Co. v. Peoria Strawboard Co.*, 65 Ill. App. 502 (1895).

An agreement between brewers in a certain city not to sell beer to any dealer indebted to any party thereto until such debt should be paid is in violation of the Missouri anti-trust statute and is, consequently, by the provision of that statute — which is the same as the Illinois provision pointed out in a preceding note — a complete defence to an action by a party to such agreement to recover the price of beer sold. *Ferd Heim Brewing Co. v. Belinder*, 97 Mo.

tical working of such a statute can hardly furnish ground for a conclusion which has been reached, that the illegality of a plaintiff organization can only be pleaded, under such a statute, when it has been previously established in direct proceedings.<sup>1</sup>

App. 64 (1902), (71 S. W. Rep. 691).

In *Chicago Wall Paper Mills v. General Paper Co.*, 147 Fed. 491 (1906), it was held in an action to recover the price of merchandise that the fact that the plaintiff was a corporation formed for purposes contrary to the Illinois anti-trust statute was no defence under the aforesaid provision of the statute, unless such corporation were organized in Illinois.

In *Peoria Gas, etc. Co. v. Peoria*, 200 U. S. 48 (1906), (26 Sup. Ct. Rep. 214), where a gas company had been denied relief by the lower court, in an action to restrain the enforcement of an ordinance fixing rates, upon the ground that it had violated the Illinois anti-trust statute, the Supreme Court of the United States said: "We shall assume that there was testimony from which the court justly found that the rates announced on August 1 were fixed by an agreement between the two companies. We shall also assume, though without deciding, that while that agreement was in force and the parties were acting under it, neither could recover for the gas that it furnished, nor could this plaintiff question the validity of the ordinance of September 4. But although the stringent provisions of the Illinois anti-trust law may apply to the case of an agreement between two gas companies fixing the price of gas, and even if while the parties are proceeding under it any party receiving gas may avoid payment therefor on that ground, and the city likewise be upheld in an ordinance establishing maximum rates which are not remunerative, yet the making of such an agreement does not subject the companies to a per-

petual penalty. Parties making an agreement, unlawful by the anti-trust act, may while the agreement is in force be subject to its penalties, but whenever they cease to act under it the penalties also cease. The punishment adheres to the offence and stops when the offence itself stops."

See also with respect to defences under such statutes, *American Handle Co. v. Standard Handle Co.* (Tenn. Ch. 1900), 59 S. W. Rep. 709; *Wylie v. National Wall Paper Co.*, 70 Ill. App. 543 (1896); *Barton v. Mulvane*, 59 Kan. 313 (1898), (52 Pac. Rep. 883).

<sup>1</sup> *Lafayette Bridge Co. v. City of Streator*, 105 Fed. 731 (1900): "The defendant is, in this suit, attempting to avail itself in a collateral proceeding of a defence based on a fact which should be determined in a direct proceeding. In other words, before a defendant can evade the payment of the purchase price of commodities, actually received, on the ground that the seller is a trust or combination, in restraint of trade, in contravention of the statute, there should be an adjudication of a competent tribunal, in a direct proceeding instituted for that purpose, determining that such seller is a trust or combination in the sense contemplated by the statute. This is in accord with the ordinary rules of statutory construction. The practical working of any other rule could not fail to emphasize the justice and necessity of so holding in cases similar to the one at bar. It cannot be insisted that the decision in one case would be binding or even persuasive in any other case. Each suit to recover purchase money, in which the statute is pleaded by way of defence, would call for a separate and distinct determination of the legal status of the

In *National Lead Co. v. Grote Paint Store Co.*,<sup>1</sup> the Court, in holding that the Missouri anti-trust statute might be pleaded, and the illegality of the plaintiff organization — a corporate combination — established, as a defence to an action of debt, said: "It is quite true, as a general rule, that questions affecting the right of a corporation to enjoy its franchise to be a corporation, or its legal entity as such, can only be raised in a direct proceeding to annul or forfeit the grant, to which the State granting the charter is a party, for the reason that, as to third parties, the legality of the corporation is avouched by its charter from the State, which reserves to itself the power to withdraw the franchises bestowed, upon evidence of fraudulent obtentions or subsequent abuse. But the existence of this rule of procedure cannot deprive the legislature of the power of enacting that inquiries affecting the validity of the charter of a corporation may be made in other proceedings than by an action in the name of the State, and this is just what was done when the anti-trust act pleaded in defendant's answer became the law of this State. . . . As it thus appears that the Act, in express terms, permits a violation of any of its provisions to be pleaded by a private person in a suit against him for the price of goods purchased of a corporation transacting business contrary to the statute, it must follow that the right to plead such a defence entitles the party so authorized by the legislature to prove what he has pleaded."

§ 446. **Criminal Proceedings. Indictments.** — State anti-trust statutes create statutory offences and prescribe penalties to be imposed upon those who commit them.<sup>2</sup> Combinations in violation of their provisions are made criminal conspiracies. They are generally declared to be "conspiracies to defraud,"

plaintiff, thereby making the claim for purchase money merely an incidental issue. This would be true even if the amount involved were but five dollars, and the case were before a justice of the peace. The result would depend upon the varying conditions of each case as affected by the skill of lawyers, the bias of jurors, and other attendant circumstances. This would inevitably lead to such

confusion as would force federal courts to so construe the statutes as to protect the due and regular administration of justice from unconscionable prolixity and irreconcilable adjudications."

<sup>1</sup> *National Lead Co. v. Grote Paint Store Co.*, 80 Mo. App. 264 (1899).

<sup>2</sup> *State v. Buckeye Pipe Line Co.*, 61 Ohio St. 545 (1900), (56 N. E. Rep. 464).

or "conspiracies against trade." While, in exceptional instances, a penalty in the form of a forfeiture is prescribed, generally the penalty is a fine for offending corporations, and a fine or imprisonment for individuals, including officers and agents of corporations.<sup>1</sup>

<sup>1</sup> The following penalties are prescribed in the anti-trust statutes of the several States for violating their provisions. (For references to statutes, see note to § 414, *ante*.)

*Alabama.* Fine of not less than \$500 nor more than \$2000 to be imposed upon any "person or corporation."

*Florida.* Fine of not more than \$5000, or imprisonment for not more than one year, or both. Applies to any person as principal, manager, director or agent.

*Illinois.* "Corporations, companies, firms and associations" punishable by fine of not less than \$500 nor more than \$2000 for first offence. Additional penalties for subsequent offences. Officers, agents and individuals may be fined not less than \$200 nor more than \$1000, or imprisoned for not more than one year, or both.

*Indiana.* Fine not exceeding \$5000 and imprisonment not exceeding one year.

*Iowa.* "Corporation, company, firm or association" may be fined not less than one nor more than twenty per cent of capital stock or money invested. Officers, agents or individuals are punishable by fine of not less than \$500 nor more than \$5000, or by imprisonment for not more than one year, or both.

*Kansas.* Fine not less than \$100 nor more than \$1000 and imprisonment for not less than thirty days nor more than six months. Applies to "all persons, companies and corporations, their officers, agents, representatives or consignees."

*Kentucky.* "Corporation, company,

firm, partnership or person or association of persons" may be fined not less than \$500 nor more than \$5000.

Any officer or agent or any individual may be fined not less than \$500 nor more than \$5000, or imprisoned for not less than six nor more than twelve months, or both.

*Louisiana.* Fine of not less than \$100 nor more than \$1000, or imprisonment for not less than six months nor more than one year, or both. Applies to any person who, as "principal, manager, director or agent," engages in, or knowingly carries out purposes of, conspiracy.

*Maine.* "Any person, incorporated or unincorporated company, or association of persons or stockholders" entering into an unlawful combination, may be fined not less than five nor more than \$10,000.

*Michigan.* Fine of not less than \$50 nor more than \$5000, or imprisonment for not less than six months, nor more than one year, or both. Applies to any person engaging in or carrying out conspiracy as "principal, manager, director, agent, servant or employer, or in any other capacity."

*Minnesota.* Fine of not less than \$500 nor more than \$5000, or imprisonment for not less than three nor more than five years.

*Mississippi.* Fine of not less than \$100 nor more than \$5000, or imprisonment for not less than three nor more than twelve months, or both. Applies to any person as "principal, director, manager, agent, or in any other capacity," engaging in or knowingly carrying out purposes of conspiracy. The minimum fine under

Of the purpose of these statutes in prescribing penalties to be imposed, not only upon corporations but upon their officers

another statute is larger. See *American Fire Ins. Co. v. State*, 75 Miss. 24 (1897), (22 So. Rep. 99).

*Missouri*. "Any person violating any of the provisions of this act, or who shall do any act prohibited or declared unlawful by the provisions of this act, shall be adjudged guilty of a felony and upon conviction thereof shall be punished by imprisonment in the penitentiary not exceeding five years, or by imprisonment in the county jail not exceeding one year, or by a fine of not less than \$500 nor more than \$5000, or by both such fine and imprisonment."

*Nebraska*. Any person, corporation, joint stock company or other association entering into contract, combination or conspiracy in violation of act is guilty of a misdemeanor punishable by fine not exceeding \$5000, or by imprisonment not exceeding one year, or both. Statute also provides for forfeiture of property owned under combination and prescribes penalties against officers of corporations.

*New Mexico*. Fine not exceeding \$1000 nor less than \$100, and imprisonment not exceeding one year, or until fine is paid. Applies to every person, whether individual, agent, officer or stockholder, violating act.

*New York*. Fine not exceeding \$5000, or imprisonment for not longer than one year, or both. Applies to every person or corporation making contract or engaging in combination in violation of act.

*North Dakota*. Any person, firm, company, association or corporation violating act and any officer, agent or receiver of any firm, company, association or corporation, or any member of the same or any individual, found guilty of a violation of act, is subject to fine of not less than \$500 nor more

than \$5000, or to imprisonment not exceeding one year, or both.

*Ohio*. Fine of not less than \$50 nor more than \$5000, or imprisonment for not less than six months nor more than one year, or both. Applies to any person engaging in, or "as principal, manager, director, agent, servant or employer, or in any other capacity," carrying out purposes of conspiracy. Each violation constitutes a separate offence.

*Oklahoma*. Fine of not less than \$50 nor more than \$500. Applies to "any individual, firm, partnership or any association of persons."

*South Carolina*. Fine of not less than \$100 nor more than \$5000, or imprisonment for not less than six months nor more than ten years, or both. Applies to any person engaging in, or as "principal, manager, director or agent, or in any other capacity," knowingly carrying out purposes of conspiracy.

*South Dakota*. Fine of not less than \$1000 nor more than \$5000. Additional penalties for second offence. Applies to "any person or persons, officers or servants of any company, copartnership or association of persons" violating provisions of act.

*Tennessee*. Fine of not less than \$100 nor more than \$5000, or imprisonment for not less than one year nor more than ten years, or both. Applies to any person engaging in, or "as principal, manager, director or agent, or in any other capacity," knowingly carrying out purposes of conspiracy.

*Texas*. "If any person shall enter into an agreement or understanding of any character to form a trust, or to form a monopoly, or to form a conspiracy in restraint of trade . . . or shall form a trust, monopoly or conspiracy in restraint of trade, or



and agents, the Supreme Court of Kentucky in *Commonwealth v. Grinstead*<sup>1</sup> said: "It seems manifest that the object of the statute was, in the first part, to impose punishment upon the corporate entities which might violate the statute, and this could be done only by a fine; and that the intention in the second part was to impose punishment upon the officers of such corporate entities or associations, and punish individuals who might be guilty of the same offence; and that in the case of natural persons, as it was possible to impose an additional penalty of imprisonment, it was imposed, in order the more effectively to deter them from committing, or permitting the corporations which they represent to commit, the offences denounced by the statute."

It is not necessary to constitute a conspiracy within the provisions of an anti-trust statute, in a common form, that the combination should actually have an effect upon competition or prices. Entering into a combination designed to affect competition or prices constitutes a complete offence.<sup>2</sup> And persons forming such a combination cannot escape criminal responsibility therefor upon the ground that there were no written articles of association and that the organization was entirely voluntary.<sup>3</sup>

Where, under the provisions of an anti-trust statute, a corporation is not indictable for entering into a conspiracy in restraint of competition, it may still be counted as a party to

shall be a party to the formation of a trust or monopoly or conspiracy in restraint of trade, or shall become a party to a trust or monopoly or conspiracy in restraint of trade, or shall do any act in furtherance of or aid to such trust or monopoly or conspiracy in restraint of trade, he shall be punished by imprisonment in the penitentiary for a period of not less than two years nor more than ten years."

*Utah.* Corporations, firms and associations may be fined not less than \$100 nor more than \$2000 for first offence. Additional penalties for subsequent offences. Officers, agents

and individuals may be fined not less than \$100 nor more than \$1000, or imprisonment for not more than one year, or both.

<sup>1</sup> *Commonwealth v. Grinstead*, 111 Ky. 203 (1900), (21 Ky. Law. Rep. 1444, 55 S. W. Rep. 720).

<sup>2</sup> *American Handle Co. v. Standard Handle Co.* (Tenn. 1900), 59 S. W. Rep. 709; *Commonwealth v. Grinstead*, 111 Ky. 203 (1900), (21 Ky. Law. Rep. 1444, 55 S. W. Rep. 720).

<sup>3</sup> *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904).

the conspiracy as distinct from its officers or agents, and with an officer or agent may make up the two or more parties necessary to constitute the conspiracy.<sup>1</sup>

In an indictment or information for conspiracy under an anti-trust statute all known parties to the conspiracy must be named, but it is not necessary to charge them all jointly with the commission of the offence.<sup>2</sup>

Where the words of an anti-trust statute are descriptive of the offence an indictment thereunder which follows the language of the statute is sufficient.<sup>3</sup> The means by which the alleged unlawful combination was intended to be effected need not be stated in an indictment nor is it necessary to set forth the evidence tending to establish its existence.<sup>4</sup>

§ 447. **Proceedings to enforce Forfeitures.** — The statutes of several States instead of prescribing penalties in the form of fine or imprisonment for the violation of their provisions prescribe them in the form of forfeitures.<sup>5</sup> Sometimes, also, the statutes

<sup>1</sup> *Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015).

<sup>2</sup> *State v. Dreany*, 65 Kan. 292 (1902), (69 Pac. Rep. 182).

<sup>3</sup> *International Harvester Co. v. Kentucky*, (Ky. 1907), 30 Ky. Law Rep. 716, 99 S. W. Rep. 637; *Commonwealth v. Grinstead*, 111 Ky. 203 (1900) (21 Ky. Law Rep. 1444, 55 S. W. Rep. 720).

<sup>4</sup> *State v. Witherspoon*, 115 Tenn. 138 (1906), (90 S. W. Rep. 852).

In this case, however, it was held that an indictment charging the defendant, as agent of a corporation, with unlawfully carrying out an agreement entered into by the corporation with others for the purpose of restricting competition and controlling prices, but which failed to state the terms of the agreement or the articles affected, was fatally defective.

An indictment charging a conspiracy to destroy competition in the sale of oil "imported into this State" refers to oil which has been imported and not oil to be imported.

*Standard Oil Co. v. State*, 117 Tenn. 618 (1907), (100 S. W. Rep. 705, 10 L. R. A. (N. S.) 1015).

As to procedure under New York statute of 1899 for the purpose of obtaining testimony before instituting proceedings, see *Matter of Davies*, 168 N. Y. 89 (1901), (61 N. E. Rep. 118, 56 L. R. A. 855).

<sup>5</sup> The provisions of the *California* act of 1907 (§ 7) are illustrative: "Each and every firm, person, partnership, corporation, or association of persons, who shall in any manner violate any of the provisions of this act, shall for each and every day that such violations shall be committed or continued, after due notice given by the attorney-general or any district attorney, forfeit and pay the sum of fifty dollars, which may be recovered in the name of the people of the State of California, in any county where the offence is committed, or where either of the offenders resides; and it shall be the duty of the attorney-general, or the district attorney of any county on the order of the attorney-general,

provide both for fines and forfeitures.<sup>1</sup> And, without special provision, it is held that for violations of the Illinois statute the State may prosecute criminally or may maintain actions of debt to recover the penalties imposed.<sup>2</sup>

A suit by the State for the recovery of penalties prescribed in a Texas statute is a civil action.<sup>3</sup> And in such a suit no right in the State to recover such penalties can be predicated upon the ground that the combination was unlawful at common law or contravened the federal anti-trust act. The penalties can be recovered only for violations of the statute upon which the action is based.<sup>4</sup>

A violation of the Arkansas statute<sup>5</sup> which subjects an offender to the forfeiture of a money penalty does not constitute a criminal offence requiring the action of the grand jury. Consequently, a constitutional provision that no person shall be held to answer a criminal charge except upon the indictment of a grand jury is inapplicable to an action by the State for the recovery of the statutory penalties.<sup>6</sup>

to prosecute for the recovery of the same. When the action is prosecuted by the attorney-general against a corporation or association of persons, he may begin the action in the supreme court of the county in which defendant resides or does business."

See also statutes of *Kansas*, *Michigan* (Act of 1899), *Ohio*, and *Texas*, referred to in note to § 414, *ante*: "*The Statutes. Development of State Legislation.*" See *Arkansas* statute in another note to this section.

<sup>1</sup> The *Nebraska* statute provides for the forfeiture to the State of property owned under or pursuant to any combination or conspiracy.

<sup>2</sup> *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904).

<sup>3</sup> *State v. Waters-Pierce Oil Co.* (Tex. 1902), 67 S. W. Rep. 1057. See also *Waters-Pierce Oil Co. v. State* (Tex. Civ. App. 1908), 106 S. W. Rep. 918.

<sup>4</sup> *Fort Worth, etc. R. Co. v. State* (Tex. 1905), 88 S. W. Rep. 370.

An action by the attorney-general to recover from a railroad company the penalties prescribed in the Texas statute of 1903 can be maintained without the consent of the State Railroad Commission.

*State v. Missouri, etc. R. Co.*, 99 Tex. 516 (1906), (91 S. W. Rep. 214).

<sup>5</sup> The *Arkansas* statute is as follows: "Any person, partnership, firm or association, or any representative or agent thereof, or any corporation or company, or any officer, representative or agent thereof, violating any of the provisions of this act, shall forfeit not less than \$200 nor more than \$5000 for every such offence, and each day such person, corporation, partnership or association shall continue to do so shall be a separate offence."

<sup>6</sup> *Hammond Packing Co. v. State*, 81 Ark. 519 (1907), (100 S. W. Rep. 407).

For consideration of *pleadings* in actions by the State for the recovery

§ 448. **Proceedings against Corporations.** — In addition to prosecutions for violations of State anti-trust statutes, viewed as criminal offences, civil remedies are generally provided against offending corporations, which take substantially the following forms:

(1) Any domestic corporation violating any of the provisions of the statute shall forfeit its charter and franchises and its corporate existence shall thereupon terminate.

(2) Any foreign corporation violating any of such provisions shall forfeit the right and privilege of doing business in the State.<sup>1</sup>

Proceedings against domestic corporations to enforce the forfeiture of their charters must, in the absence of other statutory provision, be by *quo warranto*. *Quo warranto* proceedings may also be instituted against foreign corporations to oust them from the State for violating these statutes;<sup>2</sup> or, it is held, the attorney-general may maintain a suit for an injunction to restrain them from further doing business,<sup>3</sup> or from further violating the statutes.<sup>4</sup>

of penalties, see *State v. Missouri*, etc. R. Co., 99 Tex. 516 (1906), (91 S. W. Rep. 214); *State v. Aetna Fire Ins. Co.*, 66 Ark. 480 (1899), (51 S. W. Rep. 638).

<sup>1</sup> See statutes of *Arkansas, California, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, North Carolina, North Dakota, Tennessee, Texas, Utah and Wisconsin* referred to in note to § 414, *ante*: "*The Statutes. Development of State Legislation.*"

For provisions found in several anti-trust statutes prohibiting the issue of trust certificates or the placing of the management or control of corporations in the hands of trustees, see *Illinois* statute printed in note to said § 414, *ante*.

<sup>2</sup> See cases collected in note to § 436, *ante*: "*Application of Statutes to Foreign Corporations doing Local Business.*"

When the unlawful combination

has been abandoned punishment may be by a fine instead of a general judgment of ouster.

*State v. Armour Packing Co.*, 173 Mo. 536 (1903), (73 S. W. Rep. 645, 61 L. R. A. 464).

<sup>3</sup> *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 1041, 78 Am. St. Rep. 941). See also *Hartford Ins. Co. v. Raymond*, 70 Mich. 485 (1888), (38 N. W. Rep. 474).

<sup>4</sup> *Attorney-General v. A. Booth & Co.*, 143 Mich. 89 (1906), (106 N. W. Rep. 868). See also *People v. Aachen*, etc. Fire Ins. Co., 126 Ill. App. 636 (1906).

Compare, however, *Minnesota v. Northern Securities Co.*, 123 Fed. 692 (1903), (*reversed* on other grounds, 194 U. S. 48 (1903), (24 Sup. Ct. Rep. 598)), where it was held that a court of equity, in the absence of statutory authorization, has no power to enjoin the violation of anti-trust statute.

The anti-trust statutes of several

These remedies against offending corporations are independent of the other remedies prescribed in the statutes, and an antecedent criminal conviction of a violation of such a statute is not a condition precedent to the institution of *quo warranto*, or other, proceedings.<sup>1</sup>

In *quo warranto* proceedings against a corporation upon the ground that it is a member of a combination in violation of an anti-trust statute it cannot object that the other members of the combination are not joined with it as parties defendant. It may be proceeded against whether the others can be reached or not.<sup>2</sup>

§ 449. **Actions for Damages.** — Combination agreements contrary to public policy while invalid and unenforceable at common law were not unlawful in the sense of affording a right of action to persons injured thereby. State statutes against com-

States expressly authorize the attorneys-general to institute proceedings in equity to prevent and restrain violations of their provisions. See *Missouri Rev. Stat.* (1907), § 8979.

<sup>1</sup> *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 1041, 78 Am. St. Rep. 941); *Attorney-General v. A. Booth & Co.*, 143 Mich. 89 (1906), (106 N. W. Rep. 868).

The *Nebraska* statute of 1905 provides that any corporation twice adjudged to have violated its provisions which shall thereafter violate them shall, on the suit of the attorney-general, be prohibited from further doing business in the State. It is held that, in an action to obtain an injunction under the act, the court cannot forfeit the charter of the corporation.

*State v. Omaha Elevator Co.*, 75 Neb. 654 (1906), (110 N. W. Rep. 874).

<sup>2</sup> *Attorney-General v. A. Booth & Co.*, 143 Mich. 89 (1906), (106 N. W. Rep. 868).

That foreign corporations may be ousted from the State for acts of their agents within the State, see *Waters-Pierce Oil Co. v. State*, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 936),

s. c. 177 U. S. 43 (1900), (20 Sup. Ct. Rep. 518); *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 1041, 78 Am. St. Rep. 941). As to liability, under anti-trust statutes, of agents of foreign corporations, see *State v. Phipps*, 50 Kan. 609 (1893), (31 Pac. Rep. 1097, 34 Am. St. Rep. 152, 18 L. R. A. 657). See also *State v. Schlitz Brewing Co.*, *supra*.

Under the *Missouri* statutes a foreign corporation, in accepting a license to do business in the State, agrees that notice in any matter affecting such license to its attorney of record shall be notice to it.

*State v. Standard Oil Co.*, 194 Mo. 124 (1906), (91 S. W. Rep. 1062).

For extended consideration of the appointment of receivers in proceedings by the State against corporations for violating the Texas anti-trust statutes; the rights and powers of such receivers, and the possible conflict of authority with federal receivers, see *Waters-Pierce Oil Co. v. State* (Tex. Civ. App. 1907), 103 S. W. Rep. 836; (Tex. Sup. Ct. 1907), 106 S. W. Rep. 326; (Tex. Civ. App. 1907), 105 S. W. Rep. 851; (Tex. Civ. App. 1908), 106 S. W. Rep. 918.

binations, however, go beyond the common law; make that positively unlawful which was only negatively invalid before, and thus — it is held — give rights of action to injured persons. Thus, where a statute declares a combination in restraint of competition criminal and unlawful and prescribes a penalty, it is said that any person suffering special damage by reason of the combination has a right of action therefor.<sup>1</sup>

Moreover, the State anti-trust statutes not only declare combinations previously only invalid criminal and unlawful, but, as a general rule, specifically grant to persons injured by unlawful combinations rights of action for damages or penalties. Sometimes these statutes give a purchaser of articles, the sale of which is controlled by a combination, the right to recover back the full consideration paid.<sup>2</sup> Other and more drastic provisions are along the lines of the seventh section of the federal anti-trust statute<sup>3</sup> and provide that persons injured by reason of anything declared unlawful by the act may recover the damages — and sometimes double or treble the damages — sustained.<sup>4</sup>

<sup>1</sup> *Rourke v. Elk Drug Co.*, 75 App. Div. (N. Y.) 145 (1902), (77 N. Y. Sup. 373): "The combination charged being prohibited and made criminal, every act of the defendants in furtherance of the object of the combination was unlawful, and any person suffering special injury on account of any of such acts has a right of action. It makes no difference whether such acts if done by an individual not in the combination might have been lawful, and a person suffering therefrom would be without remedy. The same acts done by agreement or combination of several are made unlawful, and for that reason a right of action follows."

Compare *Brewster v. C. Miller's Sons Co.*, 101 Ky. 368 (1897), (41 S. W. Rep. 301).

<sup>2</sup> Thus for example the *Tennessee* statute provides: "Any person or persons or corporation that may be injured or damaged by any such arrangement, contract, agreement, trust, or combination, described in

§ 1 of this act, may sue for and recover in any court of competent jurisdiction in this State of any person or persons or corporation operating such trust or combination, the full consideration or sum paid by him or them for any goods, wares, merchandise, or articles, the sale of which is controlled by such combination or trust."

<sup>3</sup> For construction of the seventh section of the federal statute, see *ante*, § 409: "*Actions for Treble Damages. Pleadings.*"

<sup>4</sup> The *Missouri* statute as amended in 1907 provides as follows: "Any person injured in his business or property by any other person or persons by reason of anything forbidden or declared to be unlawful by this act may sue therefor in any circuit court of this State in which the defendant or defendants, or any of them, reside, or have any officer, agent or representative, or in which any such defendant or any agent, officer or representative may be found,

While the statutory provision that persons injured by a combination may recover the "full consideration or sum paid" apparently prescribes a penalty, it has been held by the Supreme Court of Tennessee that the amount recoverable may also be designated as "damages."<sup>1</sup> The Court said: "It cannot be affirmed with any degree of certainty that the measure of recovery prescribed in the act is not in fact within the bounds of actual damages, for it is a matter of common knowledge that men who, in their business, become the injured victims of trusts or combinations often suffer not only a depreciation in the salable value of their commodities then on hand, but also a complete destruction of their business for the future; the aggregate losses so sustained in many instances greatly exceed the prices they originally paid for the commodities in question."

Where retail lumber dealers formed an association to prevent the sale of lumber by wholesalers to dealers not members of the association it was held, under the provisions of the Nebraska statute, that a dealer injured by such unlawful combination might maintain an action against any or all the members thereof for the recovery of the damages sustained.<sup>2</sup>

without regard to the amount in controversy and shall recover three-fold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee."

See also statutes of *California, Indiana, Kansas, Michigan, Nebraska, Oklahoma, Ohio* and *Utah*, referred to in note to § 414, ante: "*The Statutes. Development of State Legislation.*"

Most of the late comprehensive anti-trust statutes have a similar provision to that of the *Missouri* statute, excepting that they may provide for the recovery of actual or double, instead of treble, damages. A few follow the *Tennessee* form shown in a preceding note.

<sup>1</sup> *State v. Schlitz Brewing Co.*, 104 Tenn. 715 (1900), (59 S. W. Rep. 104, 78 Am. St. Rep. 941).

Compare, however, *Mason v. Adoue*, 30 Tex. Civ. App. 276 (1902), (70 S. W. Rep. 347), where it was held that the

provision authorizing the recovery back of money paid to an unlawful combination was a penalty, and not liquidated damages.

As to recovery of double damages under *Tennessee* statute of 1891, see *American Handle Co. v. Standard Handle Co.* (Tenn. Ch. 1900), 59 S. W. Rep. 709.

<sup>2</sup> *Cleland v. Anderson*, 66 Neb. 252 (1902), (92 N. W. Rep. 306).

In an action against an ice company for breach of contract to deliver ice the damages cannot be enhanced by showing that the reason why the contract was broken was that the defendant had entered into an unlawful combination in violation of the *Kansas* anti-trust statute. "The reason for the breach furnished no cause of action."

*Crystal Ice Co. v. Wylie*, 65 Kan. 104 (1902), (68 Pac. Rep. 1086).

The Missouri statute gives a person injured by a combination in violation of its provisions a right of action at law to recover treble damages, but affords no direct remedy in equity.<sup>1</sup>

§ 450. **Evidence. Production of Books.** — For reasons already considered in reference to illegal combinations generally, it is not necessary, in order to establish a violation of an anti-trust statute, to show, by direct evidence, that a combination with an unlawful object has been formed.<sup>2</sup> The facts and circumstances attending the acts of the parties may clearly show their purpose and may constitute the best evidence. Illegal combinations are seldom evidenced by written agreements stating a purpose forbidden by law.

In *State v. Firemen's Fund Ins. Co.*<sup>3</sup> the Supreme Court of Missouri said: "Of course there was no written agreement forming the trust, for that was 'inexpedient, and might make the members liable to prosecution under the trust laws,' as the president of the club well and wisely remarked when the club was formed. When people set out to do acts that are either *mala in se* or *mala prohibita*, they do not put up a sign over the door or a stamp on the act declaring their purposes and intent. Concealment is generally their prime object. But as such matters exist without agreements and rest upon common understanding and practice, so the proof of their existence may be of the same character; and while such laws are penal in their nature and should be strictly construed, . . . nevertheless a pool or trust may be as conclusively proved by facts and circum-

<sup>1</sup> C. H. Albers Commission Co. v. Spencer, 205 Mo. 105 (1907), (103 S. W. Rep. 523).

Compare Walsh v. Association of Master Plumbers, 97 Mo. App. 280 (1902), (71 S. W. Rep. 455). See also Union Pressed Brick Co. v. Chicago, etc. Brick Co., 31 Chic. Leg. News 428, 4 Chic. L. J. Wkly. 346.

<sup>2</sup> State v. Firemen's Fund Ins. Co., 152 Mo. 1 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363); Southern Electric Sec. Co. v. State (Miss. 1907), 44 So. Rep. 785; Chicago, etc. Coal Co. v. People, 214 Ill. 421 (1905), (73 N. E.

Rep. 770), *affirming* 114 Ill. App. 75 (1904); Detroit Salt Co. v. National Salt Co., 134 Mich. 1113 (1903), (96 N. W. Rep. 1); Waters-Pierce Oil Co. v. State, 19 Tex. Civ. App. 1 (1898), (44 S. W. Rep. 936). See also American Handle Co. v. Standard Handle Co. (Tenn. Ch. 1900), 59 S. W. Rep. 709. And see *ante*, § 375: "Evidence"; *ante*, § 405: "Proof of Violation of Statute. Evidence."

<sup>3</sup> State v. Firemen's Fund Ins. Co., 152 Mo. 40 (1899), (52 S. W. Rep. 595, 45 L. R. A. 363), (*per* Marshall, J.).



stances as by direct written evidence, for in this regard they are like all other frauds." <sup>1</sup>

A court having power to require any party to a suit to produce any books in its possession relating to the merits of the case may compel a corporation, charged with violating an anti-trust statute, to produce its stock book when it is material to the issues. And the stock book is material when it is claimed that a defendant corporation, while ostensibly independent, is actually controlled by another corporation through stock ownership which likewise controls its competitors.<sup>2</sup>

§ 451. **Statutes of Limitation.** — Upon the principle that every overt act is a renewal of the original conspiracy, a prosecution for a violation of a State anti-trust statute making combinations criminal conspiracies may be maintained against a continuing combination, although the statutory period has elapsed between

<sup>1</sup> It is not necessary in order to establish an unlawful combination to show that an agreement has been actually entered into. Proof of an understanding to work a common purpose is sufficient. *Chicago, etc. Coal Co. v. People*, 214 Ill. 421 (1905), (73 N. E. Rep. 770), *affirming* 114 Ill. App. 75 (1904).

For statements of evidence held sufficient to establish combinations in violation of State anti-trust statutes, see *State v. Armour Packing Co.*, 173 Mo. 356 (1903), (73 S. W. Rep. 645, 61 L. R. A. 464); *Detroit Salt Co. v. National Salt Co.*, 134 Mich. 103 (1903), (96 N. W. Rep. 1); *State v. Omaha Elevator Co.*, 75 Neb. 654 (1906), (110 N. W. Rep. 874). *Compare* *State v. Continental Tobacco*, 177 Mo. 1 (1903), (75 S. W. Rep. 737); *State v. Shippers Compress, etc. Co.*, 95 Tex. 603 (1902), (69 S. W. Rep. 58, 93 Am. St. Rep. 870, 58 L. R. A. 714); *Wilson v. Morse*, 117 Iowa, 581 (1902), (91 N. W. Rep. 823).

Where in an action upon a lease it was set up in the answer that it was taken as part of a scheme to create an unlawful monopoly and was, consequently, invalid, it was held

that the question whether the lease was made to control prices or restrict production was for the jury.

*Hartz v. Eddy*, 140 Mich. 479 (1905), (103 N. W. Rep. 852).

But where all the evidence is consistent only with an unlawful purpose the question of illegality should not be submitted to the jury.

*Detroit Salt Co. v. National Salt Co.*, 134 Mich. 103 (1903), (96 N. W. Rep. 1).

Mandamus will not lie to compel the attorney-general to institute proceedings to forfeit the charters of corporations alleged to be violating an anti-trust statute. Before he acts he must look into the facts and determine whether the evidence necessary to a successful prosecution can be obtained.

*Lewright v. Bell*, 94 Tex. 556 (1901), (63 S. W. Rep. 623).

<sup>2</sup> *State v. Standard Oil Co.*, 194 Mo. 124 (1906), (91 S. W. Rep. 1062).

For construction of *Arkansas* statute relating to the production of books and papers in prosecutions under the anti-trust act, see *Hammond Packing Co. v. State*, 81 Ark. 519 (1907), (100 S. W. Rep. 407).

the formation of the combination and the finding of the indictment.<sup>1</sup>

An action by the State for the recovery of penalties under the Texas statutes is a civil suit and is not barred by the statutes of limitation which prevent prosecutions for the criminal offences created by such statutes. And as such a suit is for the protection of the public rights, it is not barred by statutes of limitation applicable to civil actions upon the theory that it is an action of debt only.<sup>2</sup>

<sup>1</sup> *American Fire Ins. Co. v. State*,  
75 Miss. 24 (1897), (22 So. Rep.  
99).

<sup>2</sup> *Waters-Pierce Oil Co. v. State*  
(Tex. Civ. App. 1908), (106 S. W.  
Rep. 918).

# INDEX

(References are to sections. Letter "n" refers to note.)

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## A

ABSORPTION. (See MERGER.)

ACCOUNTING, after attempted consolidation, 97.

ACQUIESCENCE,

of stockholders in consolidation, 45.

implied sanction of sale, 116.

implied sanction of sale of railroad, 150.

of stockholders in lease of railroad, 192.

of stockholders in *ultra vires* stockholding, 293.

(See also ESTOPPEL.)

ACTIONS. (See PENDING SUITS; REMEDIES.)

ADMISSIONS,

consolidated corporation bound by, of constituents regarding obligations, 86.

(See also EVIDENCE; PROCEDURE.)

ADOPTION OF RAILROAD LEASES,

acknowledgment, witnesses, etc., 195.

allegation and proof of proper, 195 n.

authority of officers or agents, 195.

construction of statutes prescribing method of, 194.

estoppel to allege irregular, 196.

formalities attending, 195.

place of execution, 195.

seals, 195.

statutes prescribing method of, 193.

AGREEMENT FOR LEASE, power to make, 184.

ALABAMA,

(a) *Consolidation.*

statute authorizing consolidation of business corporations, 23 n.

statute authorizing consolidation of railroads, 22 n.

statutes prescribing method of consolidating, 52 n.

(b) *Sales.*

statutes authorizing sales of railroads, 145 n.

statute prescribing method of authorizing sale of railroad, 148 n.

## INDEX

### ALABAMA — *continued*,

- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Stockholding*.
  - statute authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.

### ALLEGATION OF CONSOLIDATION, how made, 91.

(See also PLEADINGS.)

### ALLIANCE. (See CONFEDERATION.)

### AMALGAMATION,

- compared with consolidation, 12.
- English statute authorizing, 12 n.
- remarks of English judges concerning, 12.
- uncertain meaning of term, 12.

### AMERICAN BISCUIT COMBINATION,

- formation and purposes of, 349.

### ANCILLARY CONTRACTS IN RESTRAINT OF TRADE.

(See CONTRACTS IN RESTRAINT OF TRADE; FEDERAL ANTI-TRUST STATUTE.)

### ANTI-TRUST LEGISLATION.

(See FEDERAL ANTI-TRUST STATUTE; STATE ANTI-TRUST STATUTES.)

### APPRAISAL,

- of stock of dissenting stockholders in case of exchange, 121.
- of stock of dissenting stockholders upon consolidation, 57.
- statutory provisions for, of stock, 57.
- whether court of equity can make, without statute, 121.
- whether stock can be appraised in aid of lease, 167.

### ARIZONA,

- (a) *Consolidation*.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases*.
  - statutes authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.

### ARKANSAS,

- (a) *Consolidation*.
  - constitutional provision against consolidation of competing corporations, 32 n.
  - statutes authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.

## INDEX

### ARKANSAS — *continued*,

#### (b) *Sales*.

statutes authorizing sales of railroads, 145 n.

statute prescribing method of authorizing sale of railroad, 148 n.

#### (c) *Leases*.

statute authorizing lessee to exercise right of eminent domain, 210 n.

statute authorizing railroad leases, 145 n, 180 n.

statute concerning taxation of leased railroad, 224 n.

statute prescribing method of adopting railroad lease, 193 n.

statute providing that lessor corporation shall be liable for damages, 216 n.

statute relating to foreign lessee corporations, 254 n.

#### (d) *Stockholding*.

statutes authorizing corporate stockholding, 271 n.

#### (e) *Combinations*.

anti-trust statute, 414 n.

constitutional provision against monopolies, 414 n.

### ARTICLES OF ASSOCIATION,

effect of assumption of power to hold stock in, 270.

### ASSENT OF STOCKHOLDERS. (See STOCKHOLDERS.)

### ASSESSMENTS,

corporation liable for, upon *intra vires* holdings, 287.

covenant to pay, in railroad leases, 205.

liability for, upon *ultra vires* holdings, 289.

(See also TAXES.)

### ASSIGNEES,

of illegal combination, rights and remedies of, 368.

### ASSIGNMENT,

covenant not to make, of leases, 206.

of trackage contracts, 258.

what constitutes, of lease, 206.

### ASSOCIATIONS,

application of rule of public policy to, of carrier corporations, 365.

application of rule of public policy to, of dealers, 362.

application of rule of public policy to, of gas companies, 365.

application of rule of public policy to, of manufacturers, 360.

application of rule of public policy to, of manufacturers owning patents, 361.

application of rule of public policy to, of producers, 360.

definition, 303.

formation of, 308.

forms of industrial, 308.

legality of, not generally a question of corporation law, 312.

nature of pools, 308, 364.

### ASSOCIATIONS OF RAILROAD COMPANIES,

pools, 308, 364 *a*.

## INDEX

ASSOCIATIONS OF RAILROAD COMPANIES — *continued*,  
traffic contracts of competing lines, 364.  
traffic contracts of connecting lines, 363.

ASSUMPTION,  
of power to hold stock in articles of association, 270.  
by vendee corporation of debts of vendor, 123.

## B

BONDS,  
collateral trust, 287 *a*.  
power of consolidated corporation to issue mortgage, 75.  
when guarantee of, by competing corporation amounts to consolidation, 35.

(See also BONDHOLDERS.)

BONDHOLDERS,  
election of, in case of convertible bonds, 81.  
obligations of consolidated corporation to, of constituents, 81.  
of *de facto* consolidated corporation estopped to deny regularity of consolidation, 96.  
when, cannot be deprived of right to convert bonds into stock of consolidated corporation, 81.

BOOKS,  
production of, under federal anti-trust statute, 413.  
production of, under State anti-trust statutes, 450.

BRIDGE COMPANIES,  
constitutional prohibitions against consolidation of competing, 39.

BUSINESS CORPORATIONS,  
consolidation of, statutory provisions, 23.  
construction of statutes authorizing consolidation of, 30.

## C

CALIFORNIA,  
(*a*) *Consolidation*.  
statute authorizing consolidation of mining companies, 23 n.  
statute authorizing consolidation of railroads, 22 n.  
statutes prescribing method of consolidating, 52 n.  
(*b*) *Sales*.  
statute authorizing sales of railroads, 145 n.  
statute prescribing method of authorizing sale of railroad, 148 n.  
(*c*) *Leases*.  
statute authorizing railroad leases, 180 n.  
(*d*) *Combinations*.  
anti-trust statutes, 414 n.

CALLS,  
apply to all subscriptions, 69.  
how consolidated corporation may apply amount received on, 77.  
on subscriptions made pending consolidation, continue in force, 69.

## INDEX

- CANAL COMPANIES**,  
    constitutional prohibitions against consolidation of competing, 39.
- CARRIERS**,  
    combination of, violates federal anti-trust statute, 398.  
    constitutional provisions against consolidation of competing, 39.
- CHARTER.** (See **CORPORATION.**)
- CHICAGO GAS TRUST**, nature and formation of, 346.
- CHOSSES IN ACTION**,  
    of constituents pass, upon consolidation, to consolidated company, 67.
- CITIZENSHIP**,  
    of corporation, 101 n.  
    of interstate consolidated corporation, 106.
- CIVIL REMEDIES.** (See **REMEDIES.**)
- CLAIMS.** (See **OBLIGATIONS.**)
- CLASSIFICATION**, of intercorporate relations, 1.
- CLASS LEGISLATION**,  
    State anti-trust statutes as constituting, 421.  
    (See also **FOURTEENTH AMENDMENT.**)
- COLLATERAL**, incidental power to take stock as, 278.
- COLLATERAL ATTACK**,  
    invalidity under federal anti-trust statutes as a ground of, 405.  
    invalidity under State anti-trust statutes as a ground of, 445.  
    upon combination, 369.  
    upon *de facto* consolidated corporation, 93, 94, 95.  
    upon unlawful consolidated corporation, 93.
- COLLATERAL CONTRACTS**, to *ultra vires* stockholding invalid, 290.
- COLLATERAL TRUST BONDS**,  
    duties of trustee under, 287 a.  
    nature of, 287 a.  
    rights and remedies of holders of, 287 a.
- COLORADO**,  
    (a) *Consolidation.*  
        constitutional provision against consolidation of competing corporations, 32 n.  
        statute authorizing consolidation of business corporations, 23 n.  
        statute authorizing consolidation of railroads, 22 n.  
        statutes prescribing method of consolidating, 52 n.  
    (b) *Sales.*  
        statutes authorizing sales of railroads, 145 n.  
    (c) *Leases.*  
        statute authorizing railroad leases, 145 n, 180 n.  
        statute prescribing method of adopting railroad lease, 193 n.  
    (d) *Stockholding.*  
        statutes authorizing corporate stockholding, 271 n.
- COMBINATIONS**,  
    analysis of principles determining legality of, 311.  
    analysis of rules of public policy governing, 354-359.

## INDEX

### COMBINATIONS — *continued*,

- application of rules of public policy to particular classes of, 360-365.
- basis of rules of public policy concerning, in judicial decisions, 341.
- by means of holding stock, 292.
- collateral attack upon, 369.
- connection between contracts in restraint of trade and, 335.
- control of the market, 356.
- corporate, by means of holding corporation, 323.
- corporate, by means of purchasing corporation, in general, 318.
- definition of phrase "corporate combination," 306.
- definition of term "association," 303.
- definition of term "combination," 302.
- definition of term "trust," 304.
- difficulty of formulating rules of public policy concerning, 340.
- distinction between, and consolidation, 16.
- evidence, 375.
- evolution of, 6, 307.
- formation of associations, 308.
- formation of corporate, 310.
- formation of trusts, 309.
- form of, immaterial, 354.
- forms of industrial associations, 308.
- forms of pools, 308.
- illegality of, no defence to creditors' actions, 370.
- in formation of trust, State regards acts of stockholders as acts of corporation, 313.
- issue of stock for good-will in formation of corporate, 320.
- issue of stock for property in formation of corporate, 319.
- legality of association not generally a question of corporation law, 312.
- members of illegal, cannot recover agreement upon, 366.
- modern, of capital seldom conspiracies, 328.
- modern use of term "monopoly," 332.
- nature of pools, 308.
- objects and tendencies of, 355.
- of carriers violate federal anti-trust statute, 398.
- of railroads violate federal anti-trust statute, 398.
- over-valuation of property acquired by issue of stock, 321.
- popular use of word "trust," 305.
- power of Congress to prohibit, of competing railroads, 381.
- power of Congress under commerce clause to legislate concerning, under State laws, 380.
- power of vendor corporations to sell property for stock, 322.
- power of State to prohibit, in exercise of police power, 420.
- power of State to prohibit, in exercise of reserved power, 418.
- primary meaning of term "monopoly," 329.
- quo warranto* against combining corporations, 373.



## INDEX

### COMBINATIONS — *continued*,

- quo warranto* against corporate, 372.
- remedies of members of illegal, 366.
- rights and liabilities growing out of trusts, 317.
- rights and remedies between illegal, and members, 367.
- rights and remedies of stockholders of combining corporations, 371.
- rights of debtors to attack legality of, 369.
- rights of members of illegal, 366.
- rights of receivers and assignees of illegal, 368.
- rights of, to allege its own illegality, 370.
- rules of public policy regarding, 352.
- sketch of growth of, 6.
- test of right of member to recover, 366.
- test of validity of, not whether in restraint of trade, 337.
- test of validity of, not whether monopolies, 333.
- trust invalid as delegating powers, 315.
- trust invalid as involving partnership of corporations, 314.
- trust invalid as involving practical consolidation, 316.
- what, are conspiracies, 327.

### COMMERCE,

- distinction between, and manufacture, 393.
- interstate, a matter of federal regulation, 393.
- State, a matter of State control, 393.

(See also INTERSTATE COMMERCE.)

### COMMERCE CLAUSE,

- construction of, 38 n.
- development of, 38 n, 379 n.
- operation of, upon State anti-trust legislation, 415.
- provisions of, 379 n.

### COMMUNITY OF INTEREST, meaning of phrase, 5, 296.

### COMPETING OR PARALLEL RAILROADS,

#### (a) *Consolidation*.

- constitutional and statutory provisions against consolidation of, 32.
- construction of provisions against consolidation of, 33-37.
- popular view regarding consolidation of, 31.
- public policy concerning consolidation of, 31.
- stockholder may restrain consolidation of, 40.
- State may prevent consolidation of, 40.
- what are, 37.

#### (b) *Sales*.

- constitutional and statutory provisions against purchase of, 147.

#### (c) *Leases*.

- constitutional and statutory provisions against leases of, 186.

### COMPETITION,

- distinction between restriction of, and control of the market, 356.
- lease of railroad for purpose of suppressing, against public policy, 249.

## INDEX

- COMPETITION — *continued*,  
    holding stock to prevent, 292.  
    public policy regarding, 356.
- CONDEMNATION OF STOCK, for purposes of consolidation, 51.  
    (See also APPRAISAL.)
- CONDITIONAL SUBSCRIPTIONS. (See SUBSCRIPTIONS.)
- CONFEDERATION,  
    consolidation in form of, 8.  
    exemplified in interstate consolidations, 8.
- CONGRESS,  
    cannot regulate combinations of manufacturers, 6, 393.  
    can only regulate or prohibit combinations affecting interstate  
        commerce, 391.  
    limitations upon powers of, 6.  
    power of, to prohibit combinations of competing railroads, 381.  
    power of, to legislate concerning private contracts affecting inter-  
        state commerce, 379.  
    power of, to legislate concerning contracts and combinations under  
        State laws, 380.  
    (See also COMMERCE CLAUSE.)
- CONNECTICUT,  
    (a) *Consolidation*.  
        statute authorizing consolidation of business corporations, 23 n.  
        statute authorizing consolidation of railroads, 22 n.  
        statute concerning evidence of consolidation, 91 n.  
        statutes prescribing method of consolidating, 52 n.  
    (b) *Leases*.  
        statute authorizing railroad leases, 180 n.  
        statute prescribing method of adopting railroad lease, 193 n.  
    (c) *Stockholding*.  
        statute authorizing corporate stockholding, 271 n.
- CONNECTING OR CONTINUOUS RAILROADS,  
    construction of statutes authorizing consolidation of, 29.  
    construction of statutes authorizing leases of, 185.  
    what are, 29.  
    whether connection may be by leased road, 29.
- CONSIDERATION,  
    for fraudulent sale, may be reached by creditors, 125.  
    for lease of railroad, 198.
- CONSOLIDATED CORPORATION,  
    acquires real estate and rights in streets of constituents, 66.  
    act creating, contravenes constitutional provision against creating  
        corporations by special act, 19.  
    *chooses in action* of constituent corporations pass to, 67.  
    constitutional limitations affecting obligations of, 78.  
    entitled to municipal aid voted to constituents, 70.  
    legislative recognition of, validates organization, 20.

## INDEX

### CONSOLIDATED CORPORATION — *continued*,

- liability of, for debts upon consolidation after foreclosure sale, 83.
- liability of, for torts of constituents, 82.
- liability of, general rule of, 79.
- liable upon its own obligations, 78 *a*.
- liens, takes property of constituents subject to, 84.
- may be organized for full statutory period, 19.
- miscellaneous powers of, 77.
- not purchaser for value without notice, 87.
- obligation of, to perform public duties of constituents, 80.
- obligations of, determined by constitutional limitations, 78.
- obligations of, to bondholders and preferred stockholders of constituents, 81.
- powers of, in general, 74.
- power of, to issue mortgage bonds, 75.
- remedies upon subscription contracts, 69.
- right of eminent domain, 76.
- rule as to transmission of property and franchises to, 65.
- special privileges and immunities passing to, 73.
- takes property subject to equitable liens, 85.
- terms of existence of constituent corporations do not affect, 19.
- when, takes subject to constitutional limitations, 71.
- whether entitled to exemptions from taxation of constituents, 72.

### CONSOLIDATING CORPORATIONS.

(See CONSTITUENT CORPORATIONS.)

### CONSOLIDATION,

- absorption, process of, in, 8.
- accounting after attempted, 97.
- after foreclosure, consolidated corporation not liable for debts, 83.
- allegation and proof of, 91.
- analogy in civil law, 10.
- appraisal of stock in, statutory provisions for, 57.
- arrangements amounting to, within constitutional prohibitions, 35.
- as a result and process, 9.
- assent of stockholders to, how manifested, 45.
- attempted, 92.
- authorization of, of interstate railroads not regulation of interstate commerce, 19 *a*.
- choses in action* of constituents pass upon, to consolidated corporation, 67.
- citizenship of interstate consolidated corporation, 106.
- condemnation of stock for purposes of, 51.
- consolidated corporation takes *per universitatem*, 10.
- constitutional limitations affecting result of, 71.
- constitutional prohibitions of, not regulations of interstate commerce, 38.

CONSOLIDATION — *continued*,

- constitutional provisions against, of carrier corporations other than railroads, 39.
- constitutional provisions against, of competing railroads, 32.
- construction of constitutional prohibitions against, 33, 34.
- construction of particular statutes authorizing, 28.
- construction of statutes authorizing, of business corporations, 30.
- construction of statutes authorizing, of corporations of different States, 100.
- construction of statutes authorizing, of railroads, 29.
- construction of statutes creating distinct corporation, 62.
- construction of statutes showing merger as result of, 63.
- construction of statutes prescribing method of, 54.
- conventional and statutory liens, effect of, upon, 84.
- court will not take judicial notice of, 91. .
- definitions of, 7 n.
- description of, 9.
- distinction between, and combination, 16. .
- distinction between, and control, 15.
- distinction between, and lease, 14.
- distinction between, and reorganization, 16 n.
- distinction between, and sale, 13.
- distinction between irregular and invalid, 92.
- distinction between use of term in authorizations and prohibitions, 7.
- duties of interstate consolidated corporation, 105.
- effect of, as a general rule, is creation of distinct corporation, 60.
- effect of, depends upon terms of consolidation act, 7, 59.
- effect of, in general, 58.
- effect of interstate, upon *status* of constituent corporations, 102.
- effect of irregular, 94.
- effect of unlawful, 93.
- effect of, upon stockholders of constituent corporations, 64.
- enforcement of conditional subscriptions, 69.
- enforcement of provisions against, 40.
- enforcement of subscriptions by consolidated corporation, 69.
- equitable liens, effect of, upon, 85.
- estoppel to deny regularity of, 96.
- exemptions from taxation, whether pass to consolidated corporation, 72.
- extreme development of idea of combination, 16.
- foreclosure of mortgage of interstate consolidated corporation, 107.
- formal statutory requisites for, 52.
- fraud in consolidation agreements, 98.
- fusion, process of, 8.
- incidental power to acquire stock in connection with, 279.
- includes merger, 11.

## INDEX

### CONSOLIDATION — *continued*,

- in form of confederation, 8.
- interstate, how authorized, 99.
- invalid, a nullity, 93.
- laches of stockholders in restraining invalid, 49.
- lease is not, 34.
- legislative sanction of, how expressed, 20.
- legislative ratification of, equivalent to authorization, 20.
- liability of consolidated corporation, general rule of, 79.
- management of interstate consolidated corporation, 103.
- meaning of term "in constitutional prohibitions," 33.
- merger and continued existence as result of, 61.
- miscellaneous powers of consolidated corporation, 77.
- municipal aid voted to constituent passes to consolidated corporation upon, 70.
- not dependent upon considerations of public policy, 16.
- obligations of consolidated corporation determined by constitutional limitations, 78.
- obligations of consolidated corporation, in general, 79.
- obligations of consolidated corporation to perform public duties of constituents, 80.
- obligations of consolidated corporation upon special contracts of constituents, 81.
- of business corporations, statutory provisions, 23.
- of railroads, sketch of, 2.
- outstanding contract does not prevent legislature from authorizing, 19.
- pending suits, effect of, upon, 89.
- powers of consolidated corporation, in general, 74.
- power of consolidated corporation to issue mortgage bonds, 75.
- power of legislature, in absence of reserved power, to withdraw right to consolidate, 24.
- power of legislature to authorize, 19.
- power of legislature to compel, 44.
- power of legislature to withdraw right to consolidate in exercise of police power, 26.
- power of legislature to withdraw right to consolidate in exercise of reserved power, 25.
- power to consolidate a license, 24.
- power to consolidate not a vested right, 24.
- procedure in stockholders' actions to restrain, 48.
- procedure regarding pending suits, 90.
- public policy regarding, of competing railroads, 31.
- public policy regarding, of non-competing railroads, 21.
- remedies at law of creditors of constituent corporations, 86.
- remedies in equity of creditors of constituent corporations, 87.
- remedies of dissenting subscriber in case of invalid, 47.

CONSOLIDATION — *continued*,

- remedy of creditors against constituent corporation, if not dissolved, 88.
- requisite number of stockholders whose assent is necessary, 41, 42, 43.
- rights and powers of interstate consolidated corporation, 104.
- rights and remedies of dissenting stockholders, 46.
- rule as to transfer of property and franchises by, 65.
- rules of construction of statutes authorizing, 27.
- special privileges and immunities pass to consolidated corporation, 73.
- status* of interstate consolidated corporation, 101.
- statutes authorizing, not regulations of interstate commerce, 19.
- statutes showing merger as result of, 62.
- subscriptions pass upon, to consolidated corporation, 68.
- taxation of interstate consolidated corporation, 105.
- torts of constituents, liability of consolidated corporation for, 82.
- transmission of real estate and rights in streets upon, 66.
- trust invalid as involving practical, 316.
- uncertain meaning of term, 7.
- uses of term distinguished, 8.
- what are competing or parallel lines, 37.
- what railroads may consolidate, statutory provisions, 22.
- what statutory provisions conditions precedent to, 55.
- what statutory provisions not conditions precedent to, 56.
- when consolidation is effected, 53.
- when guarantee of bonds of competing corporation amounts to, 35.
- whether control through holding corporation amounts to, 36.
- whether lease amounts to, 34.
- whether majority can effect, upon giving security, 50.
- whether right of eminent domain passes upon, 76.
- who may attack irregular, 95.
- without legislative authority, against public policy, 18.
- without legislative authority, *ultra vires*, 17.

CONSPIRACIES,

- applicability of law of, to corporations, 326.
- classification of, 324.
- criminal and civil, distinguished, 325.
- damage essential to civil, 325.
- definitions of, 324.
- definition of civil, 324.
- definition of criminal, 324.
- gist of criminal, is the combination, 325.
- modern combinations of capital seldom, 328.
- remedies and procedure in case of, 327 *a*.
- what combinations are, 327.

CONSTITUENT CORPORATIONS,

- choses in action* of, pass, upon consolidation, to consolidated company, 67.

## INDEX

### CONSTITUENT CORPORATIONS — *continued*,

- effect of consolidation upon, 58–63.
- effect of consolidation upon suits pending by or against, 89.
- effect of interstate consolidation upon *status* of, 102.
- estoppel of, of *de facto* consolidated corporation, to deny regularity of organization, 96.
- liability of consolidated corporation for torts of, 82.
- liens upon property of, not affected by consolidation, 84, 85.
- municipal aid voted to, passes to consolidated corporation, 70.
- obligations of, assumed by consolidated corporation, 79.
- obligation of consolidated corporation to perform public duties of, 80.
- obligations of consolidated corporation to preferred stockholders and bondholders of, 81.
- real estate and rights in streets of, pass to consolidated corporation, 66.
- remedies at law of creditors of, 86.
- remedies in equity of creditors of, 87.
- remedies of consolidated corporation to enforce subscriptions to, 69.
- remedies of creditors against, if not dissolved, 88.
- rule as to transmission of property of, upon consolidation, 65.
- stockholders of, effect of consolidation upon, 64.
- special contracts of, assumed by consolidated corporation, 81.
- subscriptions to, pass to consolidated corporation, 68.
- terms of existence of, do not affect consolidated corporation, 19.
- whether exemptions from taxation of, pass to consolidated company, 72.
- whether special privileges and immunities of, pass to consolidated corporation, 73.

### CONSTITUTIONAL PROVISIONS,

- against consolidation, not regulations of interstate commerce, 38.
- against consolidation of carrier corporations other than railroads, 39.
- against consolidation of competing railroads, 32.
- against leases of competing or parallel railroads, 186.
- against purchase of competing or parallel railroads, 147.
- against trusts and monopolies, 414 n.
- arrangements amounting to consolidation within, 35.
- commerce clause of federal constitution, 379 n.
- construction of, against consolidation, 33–37.
- construction of, against corporate stockholding, 274.
- construction of commerce clause, 38 n.
- defining *status* of interstate consolidated corporations, 101 n.
- development of commerce clause, 38 n.
- enforcement of, against consolidation, 40.
- Fifth Amendment, 419 n.
- Fourteenth Amendment, 419 n.
- imposing limitations upon grants of privileges and immunities, 71.
- imposing limitations upon grants of special privileges, 78.

## INDEX

### CONSTITUTIONAL PROVISIONS — *continued*,

- meaning of term "consolidation" in, 33.
  - validity of State anti-trust statutes tested by Fourteenth Amendment, 419-421.
  - validity of State anti-trust statutes under State constitutional provisions, 422.
  - what are competing or parallel lines within meaning of, 37.
  - whether control through holding corporation amounts to consolidation, 36.
  - whether lease amounts to consolidation, 34.
  - who may question constitutionality of State anti-trust statutes, 424.
- (See also **COMMERCE CLAUSE**; **FOURTEENTH AMENDMENT**; **FIFTH AMENDMENT**.)

### CONSTRUCTION OF STATUTES,

#### (a) *Consolidation.*

- authorizing consolidation of railroads, 29.
- authorizing consolidation of business corporations, 30.
- authorizing consolidation, when enabling act, 42.
- authorizing consolidation, when an impairment of contract, 42.
- consolidation statutes receive strict but not unreasonable construction, 27.
- general statutes authorizing consolidation not retroactive, 20.
- of interstate consolidation statutes, 100.
- of Minnesota, concerning consolidation, 64.
- particular consolidation statutes, 28.
- power to connect does not authorize consolidation, 28.
- prescribing method of consolidation, 54.
- rules of construction of consolidation statutes, 27.
- showing distinct corporation as a result of consolidation, 62.
- showing merger as result of consolidation, 63.
- what is a connecting or continuous line, 29.
- what statutory provisions conditions precedent to consolidation, 55.
- what statutory provisions not conditions precedent to consolidation, 56.
- whether authority to consolidate must be expressly conferred upon all consolidating corporations, 27.
- whether continuous line may be formed by leased road, 29.
- whether power to consolidate gives power to sell and *vice versa*, 28.

#### (b) *Sales.*

- relating to sales of railroads, 146.

#### (c) *Leases.*

- authorizing lease to foreign corporation, 253.
- authorizing railroad leases, 181.
- concerning leases of connecting lines, 185.
- not authorizing railroad leases, 183.



## INDEX

### CONSTRUCTION ON STATUTES — *continued*,

- power to lease unfinished road, 184.
- power to make agreement for lease, 184.
- prescribing method of adopting railroad leases, 194.
- rule of, authorizing railroad leases, 181.
- (d) *Stockholding*.
  - authorizing corporate stockholding, 273.
- (e) *Combinations*.
  - federal anti-trust statute, 386-404.
  - State anti-trust statutes, 425-444.

### CONTRACT,

- charter, between State and corporators, 17.
- grant of power to consolidate is not, 24.
- liability of lessor upon, of lessee, 222.
- outstanding, does not prevent legislature from authorizing consolidation, 19.
- power of Congress under commerce clause to legislate concerning, affecting interstate commerce, 379.
- power of Congress under commerce clause to legislate concerning, under State laws, 379.
- special, of constituent corporation assumed by consolidated corporation, 81.

### CONTRACTS IN RESTRAINT OF TRADE,

- connection between, and combinations, 335.
- conventional, are ancillary agreements, 334.
- definition of, 334.
- development of law of, 335.
- do not furnish direct test of validity of combination, 337.
- modern use of phrase, 336.
- nature of, 334.
- test of reasonableness of, 335.
- use of phrase, in federal anti-trust statute, 387.

### CONTROL,

- definition of, 294.
- distinction between, and community of interest, 296.
- distinction between, and consolidation, 15, 297.
- distinction between, of corporation and, of property, 295.
- nature of, 5.
- no implied power to purchase stock for, 298.
- phases of, 294.
- power to purchase stock to obtain, 298.
- remedies of minority stockholders of controlled corporation, 301.
- status* of corporation as controlling stockholder, 299.
- trust relation of controlling corporation to minority stockholders, 300.

### CONTROLLING CORPORATION. (See CONTROL.)

## INDEX

### CONTROL OF THE MARKET,

- distinction between, and restriction of competition, 356.
- meaning of phrase, 356.
- no limit of territory prescribed, 357.
- rule of public policy concerning, 352.
- use of phrase, 350.
- what are "useful commodities," 358.

### CONVERTIBLE BONDS,

- rights of holder of, upon consolidation, 81.

### COPYRIGHTS,

- application of federal anti-trust statute to combinations under, 400.
- are *quasi*-monopolies, 331.

### CORPORATE COMBINATIONS,

- by means of holding corporations, 310, 323.
- by means of purchasing corporation, 310, 318.
- definition of phrase, 306.
- formation of, 310.
- injunction not substitute for *quo warranto* against, 374.
- issue of stock for good-will in formation of, 320.
- issue of stock for property in formation of, 319.
- over-valuation of property acquired by issue of stock, 321.
- power of vendor corporations to sell property for stock, 322.
- quo warranto* against, 372.

### CORPORATE PROPERTY,

- effect of sale of entire, 117.
- exchange of, for stock in another corporation, 118-122, 281.
- lease of entire, of losing corporation, 167.
- lease of entire, of prosperous corporation, 166.
- sale of entire, by directors, 112.
- sale of entire, by unanimous consent, 109.
- sale of entire, of losing corporation by majority vote, 111.
- sale of entire, of prosperous corporation, by majority vote, 110.

(See also CORPORATION.)

### CORPORATE STOCKHOLDING,

- collateral trust bonds, 287 *a*.
- construction of constitutional prohibitions against, 274.
- construction of statutes authorizing, 273.
- corporation has right to vote stock, 287.
- corporation liable for assessments upon *intra vires* holdings, 287.
- distinction between control and community of interest, 296.
- distinction between control of corporation and control of property, 295.
- English rule as to necessity for statutory authority, 265.
- expediency of purchase immaterial, 269.
- incidental power to acquire stocks, in general, 275.
- incidental power to invest in stocks, 276.
- incidental power to take stock as collateral, 278.

## INDEX

### CORPORATE STOCKHOLDING — *continued*,

- incidental power to take stock for debt, 277.
- incidental power to take stock in connection with consolidation or purchase, 279.
- incidental power to take stock in exchange for corporate assets, 281.
- incidental power to take stock upon reorganization, 280.
- incidents of ownership attach to *intra vires* holdings, 287.
- liability for assessments upon *ultra vires* holdings, 289.
- meaning of term "control," 294.
- mere assumption of power to hold stocks of no effect, 270.
- miscellaneous instances of incidental power, 282.
- nature of holding corporations, 285.
- necessity for statutory authority to purchase stock, 264, 265.
- necessity for statutory authority to subscribe for stock, 266.
- outline of, 5.
- phases of control, 294.
- power of corporation to acquire and hold its own stock, 283 *a*.
- power to purchase stock to obtain control, 298.
- power to subscribe for stock in foreign corporation, 272.
- presumption of power to hold stock, 283.
- purchases through trustees or agents, 267.
- remedies in case of *ultra vires*, 293.
- remedies of minority stockholders of controlled corporation, 301.
- rights of foreign corporation as stockholder, 286.
- rule requiring statutory authority cannot be evaded by indirection, 267.
- similar nature of corporations immaterial, 268.
- status* of corporation as controlling stockholder, 299.
- status* of corporation holding stock, 284.
- statutes authorizing, 271.
- statutory authority necessary to purchase stock, 264, 265.
- subscriptions through trustees or agents, 267.
- to prevent competition, 292.
- trust relation of controlling corporation to minority, 300.
- ultra vires* contracts for purchase of stock, 290.
- validity of collateral contracts, 290.
- validity of independent contracts, 291.
- what incidents of ownership attach to *ultra vires* holdings, 288.

### CORPORATION,

- applicability of law of conspiracies to, 326.
- charter of, measure of powers, 17.
- citizenship of, 101 *n*.
- definition, 1.
- distinction between acts *ultra vires* the, and acts *ultra vires* the majority, 151.
- distinction between control of, and control of property, 295.

## INDEX

### CORPORATION — *continued*,

distinction between rules of public policy applicable to private and *quasi*-public, 351.

in formation of trust, State regards acts of stockholders as acts of, 313.

lease for longer term than existence of, may be valid, 201.

may exist without property, 117.

nature of relations of, 1-6.

power of, to acquire and hold its own stock, 283 *a*.

powers and privileges of, in foreign State, 101 *n*.

proceedings against, under State anti-trust statutes, 448.

similar nature of, does not affect power to hold stock, 268.

*status* of, as controlling stockholder, 299.

*status* of, as stockholder, 284.

*status* of, created by action of different States, 101 *n*.

*status* of foreign, 101.

trust invalid as involving partnership of, 314.

trust relation of, as controlling stockholder, 300.

trustee of property for creditors, 87.

violating State anti-trust statutes forfeits charter, 448.

when receiver may be appointed to follow assets of, 125.

(See also CONSOLIDATION; FOREIGN CORPORATION; INTERSTATE CONSOLIDATION; SALES OF RAILROADS; LEASES OF RAILROADS; CORPORATE STOCKHOLDING; COMBINATIONS.)

### COVENANTS IN RAILROAD LEASES,

assumption of interest payments, 204.

dependent and independent contracts, 203

miscellaneous, 209.

not to assign, 206.

to keep property insured, 209.

to maintain and increase business, 209.

to make repairs, 207.

to pay assessments, 205.

to pay damages and defend suits, 208.

to pay rent, 204.

to pay taxes, 205.

to pay taxes, for sole benefit of lessor, 205.

what constitutes breach of covenant not to assign, 206.

what constitutes necessary repairs within covenant, 207.

(See also LEASES OF RAILROADS.)

### CREDITORS,

#### (a) *Consolidation*.

consolidated corporation directly liable to, of constituents, 79-82.

corporation trustee of property for benefit of, 87.

estoppel of, to deny regularity of consolidation, 96.

remedies at law of, of constituent corporations, 86.

## INDEX

### CREDITORS — *continued*,

- remedies in equity of, of constituent corporations, 87.
- remedy of, against constituent corporation, if not dissolved, 88.
- rights of, not impaired by consolidation, 19.
- rights of, of constituent corporations not impaired by stipulations in consolidation agreement, 79.

#### (b) *Sales*.

- actions at law of, in case of fraudulent sale, 125.
- equitable remedies of, in case of fraudulent sale, 125.
- may sue directly vendee upon assumption clause, 123.
- mortgage by vendee takes priority over claims of, of vendor, 126.
- of vendor, cannot look to vendee unless debts are assumed or imposed by statute, 163.
- remedies of, against consideration for fraudulent sale, 125.
- remedies of, in case of fraudulent conveyances, 125.
- remedies of, upon assumption clause, in contract of sale, 125.
- vendee generally not liable for debts of vendor, 123.
- when, entitled to appointment of receiver to follow corporate assets, 125.
- when, may charge stockholders of vendor corporation, 125.

#### (c) *Corporate Stockholding*.

- remedies of, when corporation acquires its own stock, 283 *a*.

#### (d) *Combinations*.

- illegality of combination no defence to actions by, 370.

(See also FEDERAL ANTI-TRUST STATUTE; OBLIGATIONS; PENDING SUITS; REMEDIES; STATE ANTI-TRUST STATUTES.)

### CRIMINAL PROCEEDINGS,

- under federal anti-trust statute, 407.
- under State anti-trust statutes, 446.

## D

### DAMAGES,

- covenant to pay, in railroad leases, 208.
- recoverable under federal anti-trust statute, 409.
- recoverable under State anti-trust statutes, 449.

DEALERS, application of rule of public policy to associations of, 362.

### DEBT,

- incidental power to take stock as security for, 278.
- incidental power to take stock in satisfaction of, 277.

DEBTS. (See OBLIGATIONS.)

### DE FACTO CORPORATION,

- can only exist where *de jure* corporation might be created, 17, 92.
- elements necessary to form, 92.

### DE FACTO CONSOLIDATED CORPORATION,

- as a result of an irregular consolidation, 94.
- creditors of, estopped from attacking regularity of organization, 96.

## INDEX

### DE FACTO CONSOLIDATED CORPORATION — *continued*,

- estoppel to deny regularity of organization, 96.
- existence generally cannot be collaterally attacked, 94.
- under Ohio statute, 29.
- who may attack existence of, 95.

### DEFENCES.

(See ACQUIESCENCE; ESTOPPEL; PROCEDURE; REMEDIES; STOCK-HOLDERS.)

### DEFINITIONS,

#### (a) *Consolidation.*

- "consolidation," 7 n.
- "corporation," 1.
- "merger," 11.
- "*universitatis juris*," 10.

#### (b) *Sales.*

- "corporate franchises," 133.
- "franchise," 130.
- "franchise of corporate existence," 131.
- "franchises of railroad company," 133.

#### (c) *Leases.*

- "perpetuity," 187.
- "railroad lease," 175.
- "trackage contract," 255.

#### (d) *Corporate Stockholding.*

- "community of interest," 296.
- "control," 294.
- "holding corporation," 285.

#### (e) *Combinations.*

- "association," 303.
- "civil conspiracy," 324.
- "combination," 302.
- "commerce," 393.
- "conspiracy," 324.
- "contract in restraint of trade," 334.
- "contract in restraint of trade" (in modern use), 336.
- "control of the market," 356.
- "corporate combination," 306.
- "criminal conspiracy," 324.
- "engrossing," 358 n.
- "forestalling," 358 n.
- "good-will," 320.
- "manufacture," 393.
- "monopolize," 389.
- "monopoly," 329.
- "monopoly" (in modern use), 332, 389.
- "police power," 420.
- "pools," 308.

## INDEX

### DEFINITIONS — *continued*,

“public policy,” 338.

“regrating,” 358 n.

“right to contract,” 419.

“trade or commerce among the several States,” 390.

“trust,” 304.

### DELAWARE,

#### (a) *Consolidation*.

consolidation appraisal statute, 57.

statute authorizing consolidation of business corporations,  
23 n.

statute authorizing consolidation of railroads, 22 n.

statutes prescribing method of consolidating, 52 n.

#### (b) *Corporate Stockholding*.

statutes authorizing corporate stockholding, 271 n.

### DELEGATION OF POWERS,

consolidation without legislative authority, involves unlawful, 18.

trust invalid, as involving, 315.

unauthorized sale of franchise involves unlawful, 138.

### DEPENDENT AND INDEPENDENT CONTRACTS,

in connection with railroad leases, 203.

### DIAMOND MATCH COMPANY, formation and purposes of, 347.

### DIRECTORS,

#### (a) *Consolidation*.

not liable to dissenting stockholder in case of illegal consolidation, 46.

#### (b) *Sales*.

have no power to authorize sale of railroad, 149.

have no power to sell entire property of corporation not insolvent,  
112.

have power to assign property of insolvent corporation, 112.

ratification by stockholders of sale by, 113.

when same, in vendor and vendee companies, sale *prima facie*  
fraudulent, 124.

#### (c) *Leases*.

cannot lease railroad unless expressly authorized, 188.

lease by directors may be voidable, 168.

lease by, to corporation in which, are interested voidable, 248.

### DISSENTING STOCKHOLDERS. (See STOCKHOLDERS.)

### DISSOLUTION,

effect of voluntary, of combination pending proceedings under  
federal anti-trust statute, 411.

sale of entire property does not effect, of corporation, 117.

sale of railroad and franchises does not effect, of railroad company,  
152.

sale of railroad and franchises, including franchise of corporate  
existence, may effect, 152.

## INDEX

### DIVIDENDS,

- liability of consolidated corporation for, upon preferred stock of constituents, 81.
- whether consolidated corporation can declare, out of earnings of constituent before consolidation, 77.

## E

### EFFECT OF CONSOLIDATION,

- as general rule, creation of distinct corporation, 60.
  - cases of absorption or merger, 63.
  - cases showing creation of distinct corporation, 62.
  - depends upon consolidation act, 59.
  - fusion, merger or continued existence, 58.
  - interstate upon *status* of constituent corporations, 102.
  - merger and continuance of corporations, 61.
  - of unlawful, 93.
  - upon pending suits, 89.
  - upon stockholders of constituent companies, 64.
- (See also CONSOLIDATION; CONSOLIDATED CORPORATION; PENDING SUITS.)

### EMINENT DOMAIN,

- lessor corporation retains right of, 210.
- power of consolidated corporation to exercise right of, 76.
- whether right of, passes to vendee corporation upon sale of railroad, 159.
- when may be exercised by lessee, 210.

### EMPLOYEES,

- application of federal anti-trust statute to combinations of railroad, 398.
- lessor liable to, of lessee for breach of statutory or primary obligations, 220.
- of lessee corporation generally cannot look to lessor, 220.
- of lessee corporation, must look to it for damages, 220.
- remedies of, against licensee company under trackage contract, 263.
- remedies of, against proprietary company under trackage contract, 263.

(See also LEASES OF RAILROADS; LESSEE CORPORATION; LESSOR CORPORATION.)

### ENGLAND,

- amalgamation statute, 12.
- appraisal statute applicable in case of transfer for stock, 121 n.
- statute concerning issue of stock for property, 319 n.
- statute concerning railroad leases, 180 n.

ENGROSSING, definition of, 308 n.

EQUITABLE LIENS. (See LIENS.)

EQUITABLE REMEDIES. (See REMEDIES.)



## INDEX

### EQUITY RULE,

of federal courts imposing conditions upon plaintiff stockholder, 115.

### ESTOPPEL,

against *de facto* consolidated corporation, 96.

defence of, involves both knowledge and delay, 116.

when a defence to stockholder's action to prevent consolidation, 45.

when a defence to stockholder's action to prevent sale of corporate property, 116.

when a defence to stockholder's action to prevent sale of railroad, 150.

when, operates against subscriber of constituent corporation, 96.

when, operates against constituent corporations, 96.

(See also ACQUIESCENCE; REMEDIES; STOCKHOLDERS.)

### EVIDENCE,

#### (a) Consolidation.

consolidated corporation, bound by admissions of constituents regarding obligations, 86.

consolidation, how proved, 91.

existence of competition, must be established by, 37.

necessary to dissolve injunction granted dissenting stockholder, 48.

of consolidation, statutory provision, 91 n.

#### (b) Combinations.

in proceedings under federal anti-trust statute, 412.

in proceedings under State anti-trust statutes, 450.

of unlawful combination, 375.

### EXCHANGE OF CORPORATE PROPERTY FOR STOCK,

appraisal of stock of dissenting stockholders, 121.

distinction between, and sale, 118.

effect of execution of *ultra vires* contract for, 122 a.

incidental power to take stock upon, 281.

infringement of rights of dissenting stockholders, 120.

objection of *ultra vires* obviated by distribution of stock to stockholders, 119.

payment for shares of dissenting stockholders, 121.

remedies of dissenting stockholders in case of, 122 b.

stock received belongs primarily to corporation, 122.

transfer of entire corporate property without unanimous consent requires monetary consideration, 118.

whether stock having established market value can be taken, 120.

without legislative authority *ultra vires*, 119.

### EXCHANGES,

not in violation of federal anti-trust statute, 395.

### EXCLUSIVE PRIVILEGES,

charters do not confer, unless clearly expressed 133.

for selling gas, passes to consolidated corporation, 73.

grants of, as constituting monopolies, 331 n.

(See also FRANCHISES.)

## INDEX

- EXECUTION**,  
indispensable property of *quasi*-public corporation cannot be taken on, 127.  
of trackage contracts, 257.
- EXECUTION OF RAILROAD LEASES.**  
(See **ADOPTION OF RAILROAD LEASES.**)
- EXEMPTION**,  
from jury, road and military duty passes to consolidated corporation, 73.  
invalidity of, in State anti-trust statutes, 421.  
necessary to relieve lessor from primary obligations, 217.  
necessary to relieve lessor from statutory obligations, 216.  
whether necessary to relieve lessor under authorized lease, 219.
- EXEMPTIONS FROM TAXATION**,  
improvements and betterments follow property, 72.  
term "immunities" generally includes, 160.  
what language carries, upon sale of railroad, 160.  
whether, pass to consolidated corporation, 72.  
whether, pass to vendee corporation upon purchase of railroad, 160.
- EXPEDITION ACT**,  
as supplementing federal anti-trust statute, 384.  
provisions of, 384.
- EXPRESS COMPANIES**,  
constitutional prohibitions against consolidation of competing, 39.

## F

- FACILITIES FOR COMMERCE**,  
combination imposing restraints upon, not in violation of federal anti-trust statute, 394.
- FEDERAL ANTI-TRUST STATUTE**,  
actions for treble damages under, 409.  
analysis of, 377.  
application of, to combinations under copyrights, 400.  
application of, to combinations under patents, 399.  
application of, to combinations under secret processes, 401.  
application of, to contracts concerning market quotations, 402.  
applies only to restraints upon interstate commerce, 391.  
applies to combinations of carriers, 398.  
applies to combinations of railroad employees, 398.  
applies to continuing combinations, 404.  
applies to railroad combinations, 398.  
combination controlling disposition and distribution violates, 393.  
combination must have direct effect upon interstate commerce, 392.  
combination of distributors violates, 393.  
combination of manufacturers not in violation of, 393.

## INDEX

### FEDERAL ANTI-TRUST STATUTE — *continued*,

- constitutionality of, 379-382.
  - construction of, 386-404.
  - criminal proceedings under, 407.
  - damages recoverable under, 409.
  - device of holding corporation may be illegal under, 397.
  - distinction between manufacture and commerce, 393.
  - effect of voluntary dissolution pending proceedings, 411.
  - enforcement of forfeitures by government, 408.
  - evidence in proceedings under, 412.
  - exchanges not in violation of, 395.
  - form of combination immaterial, 397.
  - illegality of combination must be shown, 412.
  - immunity proviso, 385, 413.
  - inapplicable to State's monopoly, 403.
  - inapplicable to State regulations, 403.
  - indictments under, 407.
  - injunctive relief under, remedy of government only, 406.
  - invalidity under, as a ground of collateral attack, 405.
  - is constitutional, 382.
  - limitations of actions under, 410.
  - meaning of phrase "trade or commerce among the several States," 390.
  - meaning of term "monopolize," 389.
  - not in conflict with interstate commerce act, 398 n.
  - not retroactive, 404.
  - object of, 378.
  - parties to proceedings under, 406, 407, 409.
  - pleadings in actions to recover treble damages under, 409.
  - previous legality of combination immaterial, 388.
  - reasonableness of restraint imposed by combination immaterial, 388.
  - remedies under, 406-409.
  - restraint upon commerce must be direct, 392-395.
  - restraint may be imposed upon those engaged in interstate commerce by those not engaged therein, 396.
  - restraints upon facilities for commerce not in violation of, 394.
  - statute, 376.
  - title of, 386.
  - use of phrase, contract in restraint of trade, 387.
  - voluntary associations for mutual benefit not in violation of, 395.
- FEDERAL COURTS, equity rule of, applicable in stockholders' actions, 115.

(See also CITIZENSHIP.)

FIFTH AMENDMENT, provisions of, 420 n.

FLORIDA,

(a) *Consolidation*.

- statute authorizing consolidation of competing lines, 32 n.
- statute authorizing consolidation of railroads, 22 n.

FLORIDA — *continued*,

- (b) *Sales*.
  - statute authorizing sales of railroads, 145 n.
- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statute, 414 n.

FORECLOSURE,

- extinguishes claims of general creditors, 83.
- of mortgage executed by interstate consolidated corporation, 107.

FOREIGN CORPORATION,

- (a) *Consolidation*.
  - consolidation with, when authorized, 99.
  - construction of statutes authorizing consolidation with, 100.
  - status* of, 101 n.
- (b) *Sales*.
  - purchasing railroad, *status* of, 164.
  - remedies of State against, in case of unauthorized purchase of railroad, 156.
- (c) *Leases*.
  - authority to lease to, 252.
  - railroad lease to, must be authorized by State where road is located, 252.
  - status* of, leasing railroad, 254.
- (d) *Stockholding*.
  - power to subscribe for stock in, 272.
  - rights of, as stockholder in domestic corporation, 286.
  - right of, to acquire stock in domestic corporation, 286.
- (e) *Combinations*.
  - applicability of State anti-trust statutes to, 436.
  - violating State anti-trust statutes ousted from State, 448.

FORESTALLING, definition of, 358 n.

FORFEITURES,

- enforcement of, under federal anti-trust statute, 408.
- under State anti-trust statutes, 447.

FORM OF LEASE,

- habendum*, 197.
- premises, 197.
- reddendum*, 197.
- term, 197.

(See also LEASES OF RAILROADS.)

FOURTEENTH AMENDMENT,

- does not conflict with police power, 420.
- guarantees right to contract, 419.
- provisions of, 420 n.

## INDEX

### FOURTEENTH AMENDMENT — *continued*,

- State anti-trust statutes as class legislation, 421.
- validity of State anti-trust statutes tested by, 419-421.

### FRANCHISE OF CORPORATE EXISTENCE,

- belongs to stockholders, 131.
- nature of, 131.
- transferability of, 132.

### FRANCHISES,

- definition of, 130.
- distinction between sale of, and sale of railroad, 142.
- essential, pass to lessee corporation, 225.
- essential, pass upon sale of railroad, 157.
- essential elements of, 130.
- exclusive, are *quasi-monopolies*, 331.
- franchise of corporate existence, 131.
- kinds of, 130.
- leases of, 173.
- legislative authority essential to purchase of, 139.
- legislative authority essential to sale of, 135.
- municipality cannot grant, 133.
- of *quasi-public* corporations, 133.
- of railroad companies, 133.
- to construct and operate street railway, 133.
- transferability of corporate, 134.
- transferability of franchise of corporate existence, 132.
- ultra vires* sales of, 139 *a*.
- unauthorized sale of, against public policy, 137.
- unauthorized sale of, *ultra vires*, 136.
- unauthorized sale of, unlawful delegation of powers, 138.

### FRANCHISES OF CORPORATIONS,

- distinction between, and powers, 133.
- distinction between, and privileges, 133.
- fundamental nature of transfer of, 134.
- nature of, 133.
- transferability of, 134.

(See also FRANCHISES.)

### FRAUD,

- exchange of property for stock, constructively fraudulent, 124.
- in consolidation agreements, 98.
- in sales of property of private corporation, 124.
- remedies of creditors in case of, 125.
- sale in which directors are personally interested *prima facie* fraudulent, 124.
- what transfers of corporate property are fraudulent, 124.

### FUSION,

- of corporations, as a result of consolidation, 8, 58.
- (See also CONSOLIDATION.)

## INDEX

### G

#### GAS COMPANIES,

associations of, 365.

#### GEORGIA,

(a) *Consolidation.*

constitutional provision against consolidation construed, 35.

constitutional provision against consolidation of competing corporations, 32 n.

statutes authorizing consolidation of railroads, 22 n.

(b) *Sales.*

statutes authorizing sales of railroads, 145 n.

(c) *Leases.*

statute authorizing railroad leases, 145 n, 180 n.

statute concerning terms of railroad leases, 193 n.

statute imposing liability upon lessee corporation, 230 n.

(d) *Stockholding.*

statutes authorizing corporate stockholding, 271 n.

(e) *Combinations.*

anti-trust statute, 414 n.

#### GLUCOSE COMBINATION, nature and formation of, 348.

#### GOOD-WILL,

definition of, 320.

issue of stock for, in formation of corporate combination, 320.

#### GUARANTEE,

of *ultra vires* lease void, 247.

(See also LEASES OF RAILROADS.)

### H

#### HOLDING CORPORATION,

as a device to form combination may contravene federal anti-trust statute, 397.

corporate combination by means of, 310, 323.

nature of, 5, 285.

peculiar value of, 5, 285.

rights of foreign, 286.

whether control through, amounts to consolidation, 36.

### I

#### IDAHO,

(a) *Consolidation.*

constitutional provision defining *status* of interstate consolidated corporation, 101 n.

statute authorizing consolidation of railroads, 22 n.

statutes prescribing method of consolidating, 52 n.

## INDEX

### IDAHO — *continued*,

- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
- (c) *Leases*.
  - statutes authorizing leases of railroads, 145 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.

### ILLINOIS,

- (a) *Consolidation*.
  - constitutional provision against consolidation of competing corporations, 32 n.
  - public policy of, regarding consolidation of domestic and foreign railroads, 21.
  - public policy regarding consolidation of non-competing railroad, 21.
  - statute authorizing consolidation of business corporations, 23 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statute providing that consolidated corporation cannot change location of railroad, 77 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroads, 148 n.
- (c) *Leases*.
  - construction of statute of, authorizing railroad leases, 182.
- (d) *Stockholding*.
  - statute authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.
  - certain anti-trust statutes unconstitutional, 421.

### IMMUNITY PROVISIO,

- as supplementing federal anti-trust statute, 385.
- interpretation of, 413.
- provisions of, 385.

### IMPROVEMENTS,

- whether exempt from taxation, 72.
- whether lessee can recover for, made under *ultra vires* lease, 245.

### INCIDENTAL POWER TO ACQUIRE STOCK,

- as collateral, 278.
- for investment, 276.
- in connection with consolidation or purchase, 279.
- in exchange for corporate assets, 281.
- in general, 275.
- in satisfaction of debt, 277.
- miscellaneous instances, 282.
- upon reorganization, 280.

(See also CORPORATE STOCKHOLDING.)

## INDEX

### INDEPENDENT CONTRACTS,

remedies upon, of illegal combination, 369.

validity of, connected with *ultra vires* stockholding, 291.

(See also COLLATERAL ATTACK.)

### INDIANA,

#### (a) Consolidation.

statutes authorizing consolidation of railroads, 22 n.

statute prescribing method of consolidating, 52 n.

#### (b) Sales.

statutes authorizing sales of railroads, 145 n.

statute conferring powers on corporation purchasing railroad,  
158 n.

#### (c) Leases.

construction of, statute authorizing connecting railroads to make  
contracts, 183.

#### (d) Stockholding.

statutes authorizing corporate stockholding, 271 n.

#### (e) Combinations.

anti-trust statutes, 414 n.

### INDICTMENTS,

under federal anti-trust statute, 407.

under State anti-trust statutes, 446.

### INDISPENSABLE PROPERTY,

leases of, 171.

of *quasi*-public corporation cannot be alienated without statutory  
authority, 127.

of *quasi*-public corporation cannot be taken on execution without  
statutory authority, 127.

of railroad cannot be sold without statutory authority, 143.

test of indispensability, 128.

### INJUNCTION,

remedy of dissenting stockholders by, in case of invalid consolida-  
tion, 40, 46, 48.

remedy of State by, in case of *ultra vires* consolidation, 40.

remedy of State by, in case of *ultra vires* lease, 251.

remedy of State by, in case of unlawful combinations, 374.

under federal anti-trust statute, granted at instance of government  
only, 406.

(See also REMEDIES.)

### INSURANCE COMBINATIONS,

application of State anti-trust statutes to, 435.

### INTERCORPORATE RELATIONS,

distinction between relation of lessor and lessee and other, 176.

distinction between relation of vendor and vendee and other,  
141.

nature of, 1.

outline of consolidation, 2.



## INDEX

### INTERCORPORATE RELATIONS — *continued*,

- outline of corporate stockholding, 5.
- outline of evolution of combination, 6.
- outline of relations of lessor and lessee, 4.
- outline of relations of vendor and vendee, 3.

### INTERSTATE COMMERCE,

- federal anti-trust statute applies only to restraints upon, 391.
- prohibitions of consolidation not regulations of, 38.
- restraint upon, must be direct to violate federal anti-trust statute, 392-395.
- restraint may be imposed upon those engaged in, by those not engaged therein, 396.
- State anti-trust statutes not regulations of, 426.
- statutes authorizing consolidation not regulations of, 19 *a*.
- when article becomes subject of, 393.
- when, begins, 393.

### INTERSTATE COMMERCE ACT,

- not in conflict with federal anti-trust statute, 398 *n*.
- provision concerning connecting lines, 363 *n*.
- provision concerning pools, 364 *n*.

### INTERSTATE CONSOLIDATED CORPORATION,

- a domestic corporation in each State, 101.
- citizenship of, 106.
- duties of, 105.
- foreclosure of mortgage of, 107.
- jurisdiction in case of mortgage foreclosure, 107.
- management of, 103.
- rights and powers of, 104.
- status* of, 101.
- taxation of, 105.

(See also CONSOLIDATED CORPORATION; CONSOLIDATION; INTERSTATE CONSOLIDATION.)

### INTERSTATE CONSOLIDATION,

- authorization of, not regulation of interstate commerce, 19 *a*.
- effect of, upon *status* of constituent corporations, 102.
- how authorized, 99.

(See also CONSOLIDATION; FOREIGN CORPORATION; INTERSTATE CONSOLIDATED CORPORATION.)

### INTRA VIRES,

- holdings of stock, incidents of ownership attach to, 287.
- (See also CORPORATE STOCKHOLDING; ULTRA VIRES.)

### INVALID CONSOLIDATION. (See CONSOLIDATION.)

### INVALID LEASES. (See LEASES OF RAILROADS.)

### INVALID SALES.

(See SALES OF PROPERTY OF PRIVATE CORPORATION.)

### INVESTMENTS,

- incidental power to make corporate, in stocks, 276.

## INDEX

### IOWA,

- (a) *Consolidation.*
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statute authorizing sales of railroads, 145 n.
- (c) *Leases.*
  - statute authorizing mortgage of leases, 227 n.
  - statute imposing liability upon lessee corporation, 230 n.
- (d) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations.*
  - anti-trust statute, 414 n.

### IRREGULAR CONSOLIDATION.

(See also COLLATERAL ATTACK; CONSOLIDATION.)

### IRREGULAR LEASES. (See LEASES OF RAILROADS.)

## J

### JUDICIAL NOTICE,

- court may take, of geography of State and general direction of railroads, 37.
- court will not take, of consolidation, 91.

### JURISDICTION,

- of foreclosure of mortgage of interstate consolidated corporation, 107.

## K

### KANSAS,

- (a) *Consolidation.*
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statute authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases.*
  - statutes authorizing railroad leases, 145 n, 180 n.
  - statute concerning taxation of leased railroad, 224 n.
  - statute prescribing method of adopting railroad lease, 193 n.
  - statute relating to foreign lessee corporations, 254 n.
- (d) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations.*
  - anti-trust statutes, 414 n.
  - constitutionality of anti-trust statute, 420.

## INDEX

### KENTUCKY,

#### (a) *Consolidation.*

constitutional provision against consolidation of competing corporations, 32 n.

constitutional provision defining *status* of interstate consolidated corporation, 101 n.

statute authorizing consolidation of railroads, 22 n.

statute authorizing consolidation of business corporations, 23 n.

statute prescribing method of consolidating, 52 n.

#### (b) *Stockholding.*

statutes authorizing corporate stockholding, 271 n.

#### (c) *Combinations.*

anti-trust statute, 414 n.

constitutional provision against trusts and combinations, 414 n.

## L

### LABOR ORGANIZATIONS,

invalidity of exemptions of, from State anti-trust statutes, 421.

(See also CLASS LEGISLATION; FOURTEENTH AMENDMENT.)

### LACHES,

as a defence to stockholder's action to prevent sale of corporate property, 116.

of stockholders in restraining consolidation, 49.

of stockholders may prevent attacking invalid railroad lease, 192.

(See also ACQUIESCENCE; ESTOPPEL.)

### LEASE,

distinction between, and consolidation, 14.

nature of, 14.

outline of relations of lessor and lessee, 4.

statute authorizing condemnation of stock for consolidation not applicable to, 51.

whether, amounts to consolidation, 34.

(See also LEASES OF PROPERTY OF PRIVATE CORPORATIONS; LEASES OF PROPERTY OF QUASI-PUBLIC CORPORATIONS; LEASES OF RAILROADS.)

### LEASES OF PROPERTY OF PRIVATE CORPORATIONS,

distinction between, and leases of *quasi*-public corporations, 170.

of entire property of prosperous corporation, 166.

of entire property of losing corporation, 167.

of entire property of losing corporation may be made for purposes of liquidation, 167.

power to lease generally, 165.

power to take a lease, 165.

remedies of objecting stockholders, 169.

voidable leases, 168.

- LEASES OF PROPERTY OF QUASI-PUBLIC CORPORATIONS,  
 distinction between, and leases of private corporations, 170.  
 of indispensable property, 171.  
 of surplus property, 172.
- LEASES OF RAILROADS,  
 acknowledgment, witnesses, etc., 175.  
 acquiescence and laches may prevent stockholder attacking, 192.  
 allegation and proof of execution of, 195 n.  
 assent of stockholders necessary, 188.  
 authority of officers or agents to execute, 195.  
 authority to execute, must be derived from State where railroad is  
   located, 252.  
 by receiver, 238.  
 consideration, 198.  
 constitutional provisions against, when competing or parallel, 186.  
 construction of particular, 200.  
 construction of statutes authorizing leases of connecting lines, 185.  
 construction of statutes prescribing method of adopting, 194.  
 construction of statutory provisions authorizing, 182.  
 corporation may be estopped to allege irregular execution, 196.  
 covenant not to assign, 206.  
 covenant to defend suits, 208.  
 covenant to make repairs, 207.  
 covenant to pay assessments, 205.  
 covenant to pay damages, 208.  
 covenant to pay rent, 204.  
 covenant to pay taxes, 205.  
 delivery of possession under *ultra vires*, 241.  
 dependent and independent contracts, 203.  
 distinction between, and trackage contracts, 176, 255.  
 distinction between relations under, and other intercorporate rela-  
   tions, 176.  
 distinction between *ultra vires* and irregular, 239.  
 effect of *ultra vires*, upon stock subscriptions, 246.  
 enforcement of executory *ultra vires*, 240.  
 essential elements of, 175.  
 for longer term than existence of corporations may be valid, 201.  
 formalities attending execution of, 195.  
 formal parts of, 197.  
 form of, 197.  
 for purpose of suppressing competition against public policy, 249.  
 guarantee of *ultra vires*, void, 247.  
 improvements made by lessee under *ultra vires*, 245.  
 incidental franchises pass to lessee, 225.  
 injunction by State, in case of *ultra vires*, 251.  
 joint liability of lessor and lessee, 232.  
 legislative authority necessary to make, 177.

LEASES OF RAILROADS — *continued*,

- legislative authority necessary to take, 178.
- lessor cannot avoid primary obligations unless exempted, 217.
- lessor cannot avoid statutory obligations unless exempted, 216.
- lessor retains prerogative powers, 210.
- liability of lessee for debts of lessor, 233.
- liability of lessee for nuisance, 217, 231.
- liability of lessee for torts, 231.
- liability of lessor for negligent operation under authorized, 219.
- liability of lessor for negligent operation under unauthorized, 218.
- liability of lessor for nuisance, 217.
- liability of lessor for reconstruction and repairs, 223.
- liability of lessor to employees of lessee, 220.
- liability of lessor upon contracts of lessee, 222.
- liability of lessor when it shares in control, 221.
- long term, not perpetuities, 187.
- majority may authorize, in absence of controlling statute, 189.
- meaning of phrase "terminal facilities" in, 200.
- miscellaneous covenants in, 209.
- mortgages of, 227.
- mortgage of rent charge, 213.
- obligation of lessee to perform lessor's public duties, 229.
- obligation of lessor to State, 215.
- obligations of receiver after election to assume, 237.
- obligations of receiver after renunciation of, 237.
- partial invalidity of, 202.
- place of execution of, 195.
- power to lease unfinished road, 184.
- quo warranto* in case of *ultra vires*, 250.
- receiver may elect to assume or renounce, 235.
- receiver may not abrogate, as between parties, 234.
- receiver not assignee of term, 234.
- receiver's obligations pending election to assume or renounce, 236.
- record of, 195.
- recovery of property after disaffirmance of *ultra vires*, 243.
- recovery on *quantum meruit* after disaffirmance of *ultra vires*, 244.
- remedies of dissenting stockholders, 191.
- remedies of lessee, 228.
- remedies of lessor, 214.
- requisite majority prescribe terms of, 190.
- right and duty of disaffirmance of *ultra vires*, 242.
- rights of lessee, in general, 225.
- rights of lessee in matter of tolls, 226.
- rights of lessor when entitled to share of earnings, 211.
- rights of stockholders when rent is payable in form of dividends, 212.
- rules of construction of, 199.
- rule of construction of statutes, 181.

LEASES OF RAILROADS — *continued*,

- seals upon, 195.
- status* of foreign lessee corporation, 254.
- statutory liability of lessee, 230.
- statutory provisions authorizing, 180.
- statutory provisions concerning approval and execution of, 193.
- statutory provisions not authorizing, 183.
- taxation of leased railroads, 224.
- to foreign corporations, 252, 253, 254.
- typical of leases of *quasi*-public corporations, 174.
- unauthorized, validated by legislative ratification, 179.
- voidable, 248.
- void restrictions, 202.
- what constitutes, 175.
- what constitutes breach of covenant not to assign, 206.
- what statutory provisions authorize, to foreign corporations, 253.
- when lessee liable for nuisance, 217, 231.
- when lessor liable for nuisance, 217.
- whether lessor liable for negligent operation under authorized lease, 219.
- whether lessor may have equitable lien upon earnings, 211.
- whether right of eminent domain passes by, 210.
- whether unanimous consent of stockholders is necessary, 189.
- without legislative authority, against public policy, 177.
- without legislative authority, *ultra vires*, 177.

LEGAL REMEDIES. (See REMEDIES.)

LEGISLATION SUPPLEMENTING FEDERAL ANTI-TRUST STATUTE,

- anti-trust provisions of Wilson Tariff Act, 383.
- expedition act, 384.
- immunity proviso, 385.

LEGISLATIVE AUTHORITY,

(a) *Consolidation*.

- consolidation without, against public policy, 18.
- consolidation without, unlawful delegation of powers, 18.
- consolidation without, *ultra vires*, 17.
- for consolidation, how expressed, 20.

(b) *Sales*.

- essential to purchase of franchises, 139.
- essential to purchase of railroad, 144.
- essential to sale of franchises, 135.
- essential to sale of railroad, 143.
- necessary for sale of indispensable property of *quasi*-public corporation, 127.
- sale of franchises without, against public policy, 137.
- sale of franchises without, *ultra vires*, 136.
- sale of franchises without, unlawful delegation of powers, 138.

## INDEX

### LEGISLATIVE AUTHORITY — *continued*,

#### (c) *Leases*.

- lease of railroad invalid without, 177.
- necessary to take a lease, 178.
- not necessary for execution of trackage contract, 256.
- ratification of unauthorized lease validates it, 179.
- to lease railroad, must be granted by State where located, 252.

#### (d) *Stockholding*.

- necessary for corporation to purchase stock, 264.
- necessary for corporation to subscribe for stock, 266.
- rule in England as to necessity for, to purchase stock, 265.

(See also LEGISLATURE.)

### LEGISLATURE,

- outstanding contract does not prevent, from authorizing consolidation, 19.
- power of, to authorize consolidation, 19.
- power of, to compel consolidation, 44.
- power of, over property devoted to public uses, 417.
- power of, to prohibit combinations of *quasi*-public corporations, 417.
- power of, under reserved power, to change rights of shareholders among themselves, 43.
- power of, to withdraw right to consolidate, in absence of reservation, 24.
- power of, to withdraw right to consolidate in exercise of police power, 26.
- power of, to withdraw right to consolidate in exercise of reserved power, 25.
- presumption of intention of, as to succession by consolidated corporation to property of constituents, 65.

(See also LEGISLATIVE AUTHORITY.)

### LESSEE CORPORATION,

- acquires incidental franchises, 225.
- estopped to allege irregular execution of lease, 196.
- joint liability of, and lessor, 232.
- liability of, as a common carrier, 231.
- liability of, for debts of lessor, 233.
- liability of, for failure to maintain cattle guards, 230.
- liability of, for failure to maintain fences, 230.
- liability of, for fires, 230.
- liability of, for negligence, 231.
- liability of, for nuisance, 217, 231.
- liability of, for performance of lessor's public duties, 229.
- liability of, for torts, 231.
- liability of lessor for negligence of, under authorized lease, 219.
- liability of lessor for negligence of, under unauthorized lease, 218.
- liability of lessor upon contracts of, 222.
- may surrender *ultra vires* lease without liability, 241.

LESSEE CORPORATION — *continued*,

- must be expressly authorized to take lease of railroad, 178.
- obligation of, to perform lessor's public duties, 229.
- power to mortgage lease, 227.
- remedies of, 228.
- rights of, in general, 225.
- rights of, in matter of tolls, 226.
- statutory liability of, 230.
- when, agent of lessor, 222.
- when, liable for debts of lessor, 233.
- when, liable for nuisance, 217, 231.
- when, liable for taxes, 224.
- when, may exercise power of eminent domain in its own name, 210.
- when, may exercise power of eminent domain in name of lessor, 210.
- whether, may recover for improvements made under *ultra vires* lease, 45.

LESSOR CORPORATION,

- cannot avoid primary obligations unless exempted, 217.
- cannot avoid statutory obligations unless exempted, 216.
- equitable lien upon earnings, 211.
- estopped to allege irregular execution of lease, 196.
- generally liable for taxes upon leased roads, 224.
- joint liability of, and lessee, 232.
- liable for negligent operation under unauthorized lease, 218.
- liability of, for negligent operation of railroad under authorized lease, 219.
- liability of, for reconstruction and repairs, 223.
- liability of lessee for debts of, 233.
- liability of, not affected by fact that lessee is also liable, 216.
- liability of, upon contracts of lessee, 222.
- liability of, when it shares in control, 221.
- liability of, for failure to fence tracks, 216.
- liability of, for failure to maintain cattle guards, 216.
- liability of, for nuisance, 217.
- liability of, to employees of lessee for failure to perform statutory or primary duties, 220.
- may recover on *quantum meruit* after disaffirmance of *ultra vires* lease, 244.
- may recover property after disaffirmance of lease by lessee, 243.
- must be expressly authorized to lease railroad, 177.
- not liable to employees of lessee for its negligence, 220.
- obligation of lessee to perform public duties of, 229.
- obligations of, to State, 215.
- power to mortgage rent charge, 213.
- primary duties of, 217.
- public duties of, 215.
- remedies at law of, 214.



## INDEX

### LESSOR CORPORATION — *continued*,

- remedies in equity of, 214.
- retains prerogative powers, 210.
- retains right of eminent domain, 210.
- rights of, when entitled to share of earnings, 211.
- statutes providing that, shall be liable for damages, 216 n.
- statutory liability of, 216.
- when liable for injuries from fires, 216.
- when liable for nuisance, 217.
- when power of eminent domain may be exercised in name of, 210.
- whether, can recover property after disaffirmance of *ultra vires* lease, 242.

### LESSOR AND LESSEE,

- joint liability of, 232.
- outline of relations of, 4.

### LICENSE,

- grant of power to consolidate is, 24.
- trackage contract, in nature of, 255.
- (See also TRACKAGE CONTRACTS.)

### LICENSEE COMPANY,

- liability of, under trackage contract, to employees, 263.
- liability of, under trackage contract, to third persons, 262.
- (See also TRACKAGE CONTRACTS.)

### LICENSOR COMPANY. (See PROPRIETARY COMPANY.)

### LIEN,

- equitable, of lessor when entitled to share of earnings, 211.
- effect of consolidation upon conventional and statutory, 84.
- effect of consolidation upon equitable, 85.

### LIMITATIONS,

- of actions under federal anti-trust statute, 410.
- of actions under State anti-trust statutes, 451.

### LOSING CORPORATION,

- lease of entire property of, 167.
- sale of entire property of, 111.

(See also LEASES OF PROPERTY OF PRIVATE CORPORATIONS; SALES OF PROPERTY OF PRIVATE CORPORATIONS.)

### LOUISIANA,

#### (a) *Consolidation.*

- constitutional provision defining *status* of interstate consolidated corporation, 101 n.
- corporate existence of consolidated corporation limited to ninety-nine years, 77 n.
- statute authorizing consolidation of business corporations, 23 n.
- statutes authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.

## INDEX

### LOUISIANA — *continued*,

#### (b) *Combinations*.

anti-trust statute, 414 n.

constitutional provision against combinations, 414 n.

## M

### MAINE,

#### (a) *Sales*.

statute concerning sales of railroads, 145 n.

#### (b) *Leases*.

statute concerning railroad leases, 145 n.

#### (c) *Stockholding*.

statutes authorizing corporate stockholding, 271 n.

#### (d) *Combinations*.

anti-trust statute, 414 n.

### MAJORITY,

#### (a) *Sales*.

Cannot sell entire property of prosperous corporation for purposes of speculation, 110.

distinction between acts *ultra vires* the, and acts *ultra vires* the corporation, 151.

may sell entire property of prosperous corporation for purposes of liquidation, 110.

obligation of, to minority in case of sale of corporate property, 114.

power of, to sell entire property of losing corporation, 111.

power of, to sell not limited to failing concerns, 110.

whether, can authorize sale of railroad, 149.

#### (b) *Leases*.

cannot lease entire property of prosperous corporation, 166.

fiduciary relation of, towards minority, 168.

lease by, may be voidable, 168.

lease by, to corporation in which, are interested may be voidable, 248.

may authorize lease of entire property of losing corporation, 167.

may authorize lease of railroad in absence of controlling statute, 189.

prescribed, fix terms of railroad lease, 190.

(See also CONSOLIDATION.)

### MANDAMUS,

when, may be granted to compel recording of consolidation agreement, 55.

### MANUFACTURE,

combinations relating solely to, not in violation of federal anti-trust statute, 393.

distinction between, and commerce, 393.

## INDEX

### MANUFACTURERS,

- associations of, 360.
- combination of, when in violation of federal anti-trust statute, 393.
- owning patents, associations of, 361.

### MARKET QUOTATIONS,

- application of federal anti-trust statute to contracts concerning, 402.

### MARYLAND,

- (a) *Consolidation.*
  - statute authorizing consolidation of business corporations, 23 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statute authorizing sales of railroads, 145 n.
- (c) *Leases.*
  - statute authorizing railroad leases, 145 n, 180 n.
- (d) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations.*
  - constitutional provision against monopolies, 414 n.

### MASSACHUSETTS,

- (a) *Leases.*
  - statute authorizing railroad leases, 180 n.
  - statutes prescribing method of adopting railroad lease, 193 n.
- (b) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.

### MERGER,

- as a result of consolidation proceedings, 8, 61.
- definition of, 11.
- included in term "consolidation," 11.
- outline of process of, 8.
- statutes showing, as a result of consolidation, 63.
- when, may be effect of consolidation, 58.

(See also CONSOLIDATION.)

### MICHIGAN,

- (a) *Consolidation.*
  - constitutional provision against consolidation of competing corporations, 32 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statute authorizing consolidation of street railway, electric, and gas companies, 23 n.
  - statute prescribing method of consolidating, 52 n.
  - statutory provision as to powers of consolidated corporation, 77 n.
- (b) *Sales.*
  - statutes authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.

## INDEX

### MICHIGAN — *continued*,

- (c) *Leases*.
  - statute authorizing lessee to condemn in name of lessor, 210 n.
  - statutes authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
  - statute relating to foreign lessee corporations, 254 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.

### MINNESOTA,

- (a) *Consolidation*.
  - statutes against consolidation of competing railroads, 35 n.
  - statutes authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.

### MINORITY,

- obligation of majority to, in case of sale of corporate property, 114.
  - remedies of, in case of voidable leases, 248.
  - right of, to avoid leases authorized by majority, 168.
  - trust relation of controlling corporation to, 300.
- (See also MAJORITY.)

### MISSISSIPPI,

- (a) *Consolidation*.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Leases*.
  - statute authorizing railroad leases, 180 n.
- (c) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (d) *Combinations*.
  - anti-trust statutes, 414 n.
  - constitutional provision against trusts and combinations, 414 n.

### MISSOURI,

- (a) *Consolidation*.
  - constitutional provision against consolidation of competing corporations, 32 n.

## INDEX

### MISSOURI — *continued*,

- constitutional provision defining *status* of interstate consolidated corporation, 101 n.
- statute authorizing consolidation of manufacturing companies, 23 n.
- statutes authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.
- statute providing that consolidated corporation may hold necessary real estate, 77 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
  - statute concerning taxation of leased railroad, 224 n.
  - statute prescribing method of adopting railroad lease, 193 n.
  - statute relating to foreign lessee corporations, 254 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.

### MONOPOLIES,

- grants of exclusive privileges as constituting, 331 n.
- growth of, 330.
- history of, 330.
- illegality of, 330.
- modern use of term, 332.
- no true, in United States, 331.
- patents and other *quasi*, 331.
- primary meaning of term, 329.
- test of validity of combinations, not whether constitute, 333.
- use of term, in federal anti-trust statute, 389.

### MONOPOLIZE,

- use of term, in federal anti-trust statute, 389.

### MONTANA,

- (a) *Consolidation*.
  - constitutional provision against consolidation of competing corporations, 32 n.
  - constitutional provision defining *status* of interstate consolidated corporation, 101 n.
  - statute authorizing consolidation of mining companies, 23 n.
  - statutes authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statutes prescribing method of authorizing sale of railroad, 148 n.

## INDEX

### MONTANA — *continued*,

- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
  - statute concerning taxation of leased railroad, 224 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statute unconstitutional, 414 n.

### MORTGAGES,

- effect of consolidation upon, 84.
- foreclosure of, executed by interstate consolidated corporation, 107.
  - of leases, 227.
- of vendee corporation, take priority over claims of vendor's creditors, 126.
- power of consolidated corporation to issue bonds secured by, 75.
- whether lease comes within "after acquired property" clause, 227.
  - (See also BONDS; BONDHOLDERS.)

### MUNICIPAL AID,

- consolidated corporation entitled to, voted to constituents, 70.
- to railroads against present public policy, 70.

## N

### NEBRASKA,

- (a) *Consolidation*.
  - constitutional provision against consolidation of competing corporations, 32 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
  - statute concerning taxation of leased railroad, 224 n.
  - statute prescribing method of adopting railroad lease, 193 n.
  - statute relating to foreign lessee corporations, 254 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statute, 414 n.
  - constitutionality of anti-trust statute, 421.

### NECESSARIES OF LIFE,

- what articles constitute, 358.

### NEGLIGENCE,

- liability of lessee for, 231.
- liability of lessor for; of lessee under authorized lease, 219.

## INDEX

### NEGLIGENCE — *continued*,

- liability of lessor for, of lessee under unauthorized lease, 218.
- liability of lessor for, when it shares in control, 221.
- liability of parties to trackage contracts for, 261-263.
- liability of vendor for, 154, 155.

### NEVADA,

#### (a) *Consolidation.*

- statute authorizing consolidation of corporations generally, 23 n.
- statute authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.

#### (b) *Sales.*

- statute authorizing sales of railroads, 145 n.
- statute conferring powers on corporation purchasing railroad, 158 n.

#### (c) *Stockholding.*

- statutes authorizing corporate stockholding, 271 n.

### NEW HAMPSHIRE,

#### (a) *Consolidation.*

- statute authorizing consolidation of railroads, 22 n.

#### (b) *Leases.*

- statutes authorizing railroad leases, 180 n.
- statute prescribing method of adopting railroad lease, 180 n.
- statute providing that lease shall not affect lessor's public obligation, 215 n.

### NEW JERSEY,

#### (a) *Consolidation.*

- statute authorizing consolidation of business corporations, 23 n.
- statutes authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.

#### (b) *Sales.*

- statute authorizing purchase of railroad, 145 n.
- statute prescribing method of authorizing sale of railroad, 148 n.

#### (c) *Leases.*

- statutes authorizing railroad leases, 180 n.
- statute prescribing method of adopting railroad lease, 180 n.

#### (d) *Stockholding.*

- statutes authorizing corporate stockholding, 271 n.

#### (e) *Combinations.*

- statute authorizing issue of stock for property, 319 n.

### NEW MEXICO,

#### (a) *Consolidation.*

- statute authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.

#### (b) *Sales.*

- statute authorizing purchase of railroads, 145 n.
- statute prescribing method of authorizing sale of railroad, 148 n.

NEW MEXICO — *continued*,

- (c) *Leases*.
  - statutes authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.

NEW YORK,

- (a) *Consolidation*.
  - public policy of, regarding consolidation of non-competing railroads, 21.
  - statute authorizing consolidation of business corporations, 23 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.
  - statute prescribing obligations of consolidated corporation, 79 n.
  - statute relating to transmission of property and franchises upon consolidation, 65.
  - statute regarding effect of consolidation upon pending suits, 89 n.
  - statutory provision as to powers of consolidated business corporation, 77 n.
- (b) *Sales*.
  - statute authorizing acquisition of railroad, 145 n.
- (c) *Leases*.
  - construction of statute of, authorizing railroad leases, 182.
  - statute authorizing railroad leases, 180 n.
  - statutes imposing liabilities upon lessee corporation, 230 n.
  - statute prescribing method of adopting railroad lease, 180 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 201 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.

NON-COMPETING RAILROADS,

- public policy regarding consolidation of, 21.

NORTH CAROLINA,

- (a) *Leases*.
  - statute authorizing railroad leases, 180 n.
  - statute concerning taxation of leased railroad, 224 n.
- (b) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (c) *Combinations*.
  - anti-trust statute, 414 n.
  - constitutional provision against monopolies, 414 n.

NORTH DAKOTA,

- (a) *Consolidation*.
  - constitutional provision against consolidation of competing corporations, 32 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.



**NORTH DAKOTA** — *continued*,

- (b) *Sales*.
  - statute authorizing sales of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Combinations*.
  - anti-trust statute, 414 n.
  - constitutional provision against combinations, 414 n.

**NORTHERN SECURITIES CASE**,

review of, 397 a.

**NUISANCE**,

- joint liability of lessor and lessee for, 232.
- lessee liable for maintaining, 217.
- lessor liable for creating, 217.
- liability of lessee for creating or maintaining, 231.

O

**OBLIGATIONS**,

- (a) *Consolidation*.
    - liability of consolidated corporation after foreclosure for, of constituents, 83.
    - of constituents, assumed by consolidated corporations, 79.
    - of interstate consolidated corporation, 105.
    - of subscribers of constituents enforced by consolidated corporation, 69.
    - public, of constituents assumed by consolidated corporation, 80.
    - settlement of, of constituents by consolidated corporation, 77.
  - (b) *Sales*.
    - of vendor not assumed by vendee upon purchase of railroad, 163.
    - vendee not generally liable upon, of vendor, 123.
  - (c) *Leases*.
    - when lessee liable for, of lessor, 233.
- (See also CREDITORS.)

**OHIO**,

- (a) *Consolidation*.
  - statute authorizing consolidated corporation to take and dispose of stocks and bonds, 77 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statute authorizing sales of railroads, 145 n.
  - statute conferring powers on corporation purchasing railroad, 158 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.

## INDEX

### OHIO — *continued*,

- (c) *Leases*.
  - statute authorizing lessee to exercise right of eminent domain, 210 n.
  - statutes authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
  - statute providing that lessor shall be liable as if operating railroad, 216 n.
- (d) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations*.
  - anti-trust statutes, 414 n.

### OKLAHOMA,

- (a) *Consolidation*.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales*.
  - statutes authorizing sales of railroads, 145 n.
  - statute conferring powers on corporation purchasing railroad, 158 n.
- (c) *Leases*.
  - statute authorizing railroad leases, 145 n, 180 n.
- (d) *Combinations*.
  - anti-trust statutes, 414 n.
  - constitutional provision against monopolies, 414 n. .

### OREGON,

- statute authorizing sales of railroads, 145 n.
- statute authorizing railroad leases, 145 n, 180 n.

## P

### PARALLEL LINES. (See COMPETING OR PARALLEL RAILROADS.)

### PARTIES,

- in stockholders' actions to enjoin sales, 115.
- necessary, in proceedings under federal anti-trust statute, 406, 407, 409.

(See also PROCEDURE; REMEDIES.)

### PATENTS,

- application of federal anti-trust statute to combinations under, 399.
- are *quasi-monopolies*, 331.
- associations of manufacturers owning, 361.

### PENALTIES,

- under federal anti-trust statute, 407, 409.
- under State anti-trust statutes, 446, 449.

(See also FORFEITURES.)

## INDEX

### PENDING SUITS,

- effect of consolidation upon, 89.
- procedure regarding, 90.

### PENNSYLVANIA,

#### (a) *Consolidation*,

- constitutional provision against consolidation of competing corporations, 32 n.
- statutes authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.

#### (b) *Sales*.

- statute authorizing acquisition of railroad franchises and property, 145 n.
- statute conferring powers on corporation purchasing railroad, 158 n.
- statute prescribing method of authorizing sale of railroad, 148 n.

#### (c) *Leases*.

- statute authorizing lessee to assume obligations of lessor, 225 n.
- statute authorizing railroad leases, 180 n.

#### (d) *Stockholding*.

- statutes authorizing corporate stockholding, 271 n.

### PERPETUITIES,

- definition of, 187.
- long-term leases not prohibited by statutes against, 187.

### PLEADINGS,

- allegation of execution of lease, 195 n.
- allegation of consolidation, 91.
- in actions to recover treble damages under federal anti-trust statute, 409.
- what allegations necessary to dissolve injunction restraining attempted consolidation, 48.

(See also PROCEDURE.)

### POCAHONTAS COKE COMPANY,

- nature and formation of, 348 *a*.

### POLICE POWER,

- definition of, 420.
- fourteenth amendment does not conflict with, 419.
- power of State under, to withdraw right to consolidate, 26.
- power of State under, to enact anti-trust statutes, 420.

### POOLS,

- money, 308.
- nature of, 308.
- New Hampshire statute against, 35 n.
- provisions of interstate commerce act concerning, 364.
- traffic, 308.
- validity of railroad, 364 *a*.

## INDEX

### POWER OF CORPORATION TO ACQUIRE AND HOLD ITS OWN STOCK,

- American doctrine, 283 *a*.
- English doctrine, 283 *a*.
- rights and remedies of creditors, 283 *a*.
- statutes granting, 283 *a*.
- statutes prohibiting, 283 *a*.
- status* of corporation as holder of its own stock, 283 *a*.

### POWERS,

#### (a) *Consolidation.*

- charter of corporation measure of, 17.
- miscellaneous, of consolidated corporation, 77.
- of consolidated corporation, eminent domain, 76.
- of consolidated corporation, in general, 74.
- of consolidated corporation to issue of mortgage bonds, 75.
- of corporation, how conferred, 17.
- of interstate consolidated corporation, 104.

#### (b) *Sales.*

- distinction between franchises of corporation and, 133.
- of private corporation, to purchase and sell, 108.
- of vendor corporation after sale of railroad, 153.

#### (c) *Leases.*

- lessor corporation retains its prerogative, 210.

(See also CONSOLIDATED CORPORATION; CONSOLIDATION; CORPORATION; LESSOR CORPORATION; LESSEE CORPORATION; VENDOR CORPORATION; VENDEE CORPORATION.)

### PRESERVERS TRUST, nature and formation of, 345.

### PRESUMPTION,

- of citizenship, for jurisdictional purposes, 101 *n*.
- of power to hold stock, 283.
- that certificate of consolidation has been recorded, 55.

### PRIORITY,

- of purchaser's mortgage over claims of vendor's creditors, 126.

### PRIVATE CORPORATIONS.

(See CORPORATIONS.)

### PRIVILEGES AND IMMUNITIES,

- constitutional limitations upon transmission of, upon consolidation, 71.
- whether special, pass upon consolidation, 73.

(See also EXEMPTIONS FROM TAXATION; FRANCHISES; RATES OF FARE.)

### PROCEDURE,

- defences in stockholders' action to enjoin sale of corporate property, 116.
- in stockholders' action to enjoin sale of corporate property, 115.
- in stockholders' actions to restrain consolidation, 48.
- in suits pending at time of consolidation, 90.

(See also EVIDENCE; PARTIES; PLEADINGS; REMEDIES.)

## INDEX

### PRODUCERS,

associations of, 360.

associations of, when in violation of federal anti-trust statute, 393.

### PROPERTY,

devoted to public uses, power of State over, 406.

issue of stock for, in formation of corporate combination, 319.

(See also CORPORATE COMBINATION; CORPORATE PROPERTY.)

### PROPRIETARY COMPANY,

liability of, under trackage contract, to employees, 263.

liability of, under trackage contract, to third persons, 261.

(See also TRACKAGE CONTRACTS.)

### PROSPEROUS CORPORATION,

lease of entire property of, requires unanimous consent, 166.

sale of entire property of, requires unanimous consent, 110.

### PUBLIC DUTIES,

corporation purchasing railroad assumes accompanying, 162.

lessor corporation must discharge, 215.

obligation of lessee to perform lessor's, 229.

obligation of consolidated corporation to perform, of constituents,  
80.

### PUBLIC POLICY,

#### (a) *Consolidation.*

consolidation not dependent upon considerations of, 16.

consolidation, without legislative authority, against, 18.

regarding consolidation of competing railroads, 31.

regarding consolidation of non-competing railroads, 21.

#### (b) *Sales.*

unauthorized sale of franchises, against, 137.

#### (c) *Leases.*

lease of railroad for purpose of suppressing competition against,  
249.

unauthorized lease of railroad against, 177.

unauthorized taking of lease against, 178.

#### (d) *Combinations.*

basis of, 338.

basis of rules of, in judicial decisions, 341.

definition of, 338.

difficulty of formulating rules of, concerning combinations,  
340.

nature of, 338.

necessity for rules of, 339.

regarding competition, 356.

regarding combinations generally, 6.

rules of, 352.

(See also RULES OF PUBLIC POLICY.)

### PURCHASE OF FRANCHISES.

(See FRANCHISES; SALES OF FRANCHISES.)

## INDEX

### PURCHASE OF RAILROADS.

(See SALES OF RAILROADS.)

### PURCHASING CORPORATION.

(See VENDEE CORPORATION.)

## Q

### QUANTUM MERUIT,

recovery on, by lessor corporation after disaffirmance of *ultra vires* lease, 244.

(See also LEASES OF RAILROADS.)

### QUASI-PUBLIC CORPORATIONS,

#### (a) Consolidation.

consolidation of, without legislative authority, against public policy, 18.

railroad companies are, 18 n.

#### (b) Sales.

indispensable property of, cannot be sold without statutory authority, 127.

indispensable property of, cannot be taken on execution without statutory authority, 127.

legislative authority essential to purchase of franchises of, 139.

legislative authority essential to sale of franchises of, 135.

nature of franchises of, 133.

sales of surplus property of, 129.

test of indispensability of property of, 128.

transferability of franchises of, 134.

unauthorized sales of franchises of, against public policy, 137.

unauthorized sale of franchises of, *ultra vires*, 136.

unauthorized sale of franchises of, unlawful delegation of powers, 138.

#### (c) Leases.

leases of franchises of, 173.

leases of indispensable property of, 171.

leases of surplus property of, 172.

railroad leases typical of leases of, 174.

#### (d) Combinations.

analysis of rule of public policy applicable to, 359.

associations of, 365.

distinction between rules of public policy applicable to private and, 351.

power of State to prohibit combinations of, 417.

rule of public policy applicable to, 352.

### QUO WARRANTO,

against combining corporations, 373.

against corporate combination, 372.

in case of *ultra vires* consolidation, 40.

in case of *ultra vires* leases, 250.

## INDEX

### QUO WARRANTO — *continued*,

in case of unauthorized sale, 156.

judgment in, 373.

(See also REMEDIES; STATE.)

## R

### RAILROAD COMPANIES,

are *quasi*-public corporations, 18 n.

combinations of, violate federal anti-trust statute, 398.

franchises of, 133.

power of Congress to prohibit combinations of competing, 381.

sketch of consolidation of, 2.

(See also ASSOCIATIONS OF RAILROAD COMPANIES; CONSOLIDATION;  
SALES OF RAILROADS; LEASES OF RAILROADS; POOLS; TRACK-  
AGE CONTRACTS.)

### RAILROADS,

highways, early theory, 2 n.

sketch of leases of, 4.

sketch of sales of, 3.

unconstructed, when within provisions of consolidation act, 29.

unfinished, when may be leased, 184.

(See also titles containing words "RAILROADS" or "RAILROAD  
COMPANIES.")

### RAILROAD EMPLOYEES,

application of federal anti-trust statute to combinations of, 398.

### RAILROAD LEASES UNDER RECEIVERSHIP.

(See LEASES OF RAILROADS; RECEIVERS.)

### RAILROAD POOLS. (See POOLS.)

### RATES OF FARE,

consolidated corporation may exercise power of constituent regard-  
ing, 77.

right of lessee to fix, 226.

whether chartered rates follow railroad when sold, 161.

whether right to fix, passes to vendee corporation, 161.

### RATIFICATION,

#### (a) *Consolidation.*

legislative recognition of consolidation equivalent to, 20.

#### (b) *Sales.*

by stockholders of sale by directors, 113.

governed by same principles as authorization, 113.

#### (c) *Leases.*

distinction between, by legislature and stockholders, 179.

legislative, validates unauthorized railroad lease, 179.

legislative, what constitutes, 179.

(See also LEGISLATIVE AUTHORITY.)

### REAL ESTATE,

transmission of, upon consolidation, 66.

## INDEX

### RECEIVER,

#### (a) *Sales.*

when may be appointed to follow corporate assets, 125.

#### (b) *Leases.*

may elect within reasonable time to assume or renounce lease, 235.

may not abrogate lease as between parties, 234.

not assignee of term of railroad lease, 234.

obligations of, after election to assume lease, 237.

obligations of, after election to renounce lease, 237.

obligations of, pending election to assume or renounce lease, 236.

power to lease railroad, 238.

power to take lease of railroad, 238.

what constitutes election to assume or renounce lease, 235.

what constitutes reasonable time within which to elect to assume or renounce lease, 235.

#### (c) *Combinations.*

of illegal combination, rights and remedies of, 368.

### RECOGNITION,

legislative, of consolidated corporation validates organization, 20.

(See also RATIFICATION.)

### RECONSTRUCTION AND REPAIRS,

liability of lessor corporation for, 223.

### REGRATING,

definition of, 358 n.

### REMEDIES,

#### (a) *Consolidation.*

against consolidating corporations if not dissolved, 88.

enforcement of constitutional provisions against consolidation, 40.

equitable, of creditors of consolidating corporations, 87.

legal, of creditors of consolidating corporations, 86.

of consolidated corporation to enforce subscriptions, 69.

of dissenting stockholder in case of invalid consolidation, 46.

of dissenting subscribers in case of invalid consolidation, 47.

procedure in stockholders' actions to restrain consolidation, 48.

#### (b) *Sales.*

of creditors against consideration for fraudulent sale, 125.

of creditors against stockholders of vendor corporation, 125.

of creditors, at law, in case of fraudulent sale, 125.

of creditors, in equity, in case of fraudulent sale, 125.

of creditors upon assumption clause in contract of sale, 125.

of dissenting stockholders in case of invalid sale, 114.

of dissenting stockholders in case of invalid sale of railroad, 151.

#### (c) *Leases.*

against licensee company under trackage contract, 262, 263.

against proprietary company under trackage contract, 261, 263.



## INDEX

### REMEDIES — *continued*,

- of lessee corporation, 228.
- of lessor corporation, in equity, 214.
- of lessor corporation after disaffirmance of *ultra vires* lease, 242, 243, 244.
- of State in case of *ultra vires* leases, 250, 251.
- of stockholders in case of unauthorized railroad lease, 191.
- of stockholders to restrain lease, 169.
- (d) *Stockholding*.
  - of minority stockholders of controlled corporation, 301.
  - of State in case of *ultra vires* stockholding, 293.
  - of stockholders in case of *ultra vires* stockholding, 293.
  - stockholder may enjoin voting *ultra vires* holdings of stock, 288.
- (e) *Combinations*.
  - between combination and its members, 367.
  - collateral attack upon combination, 369.
  - injunction by State against illegal combination, 374.
  - injunction not a substitute for *quo warranto*, 374.
  - member of illegal combination cannot recover upon, 366.
  - of members of illegal combination, 366.
  - of receivers and assignees of illegal combinations, 368.
  - of stockholders of combining corporations, 371.
  - quo warranto* against corporate combination, 372.
  - test of right of member of illegal combination to recover, 366.
  - under federal anti-trust statute, 406-409.
  - under State anti-trust statutes, 446-449.
  - upon independent contracts of illegal combination, 369.

### RENT,

- by stipulation may be paid to third person, 198.
- consideration of lease is, 198.
- covenant to pay, 204.
- due primarily to lessor, 198.
- equitable lien upon share of earnings, 211.
- rights of stockholders when, payable in form of dividends, 212.
- share of earnings as, 211.

(See also LEASES OF RAILROADS.)

### REORGANIZATION,

- corporation takes property under, as successor, 141.
- distinction between, and consolidation, 16 n.
- distinction between, and sale of railroad, 141.
- incidental power to take stock upon, 280.

(See also EXCHANGE OF CORPORATE PROPERTY FOR STOCK; SALES OF PROPERTY OF PRIVATE CORPORATIONS.)

### REPAIRS,

- covenant to make, in railroad leases, 207.
- what constitutes necessary, 207.

RESERVED POWER,

- power of legislature to withdraw or limit right to consolidate in absence of, 24.
- power of legislature to withdraw or limit right to consolidate in exercise of, 25.
- power of state to prohibit combinations of corporations in exercise of, 418.

RIGHT OF EMINENT DOMAIN. (See EMINENT DOMAIN.)

RIGHT TO CONTRACT,

- as affected by State anti-trust statutes, 419.
- not absolute, 419.
- under Fifth Amendment, 420.
- under Fourteenth Amendment, 419.

RIGHT TO VOTE,

- corporation has, *intra vires* holdings, 287.
- corporation has no, *ultra vires* holdings, 288.

RIGHTS IN STREETS,

- transmission of, upon consolidation, 66.

RULES OF PUBLIC POLICY,

- analysis of rule applicable to *quasi*-public corporations, 359.
- analysis of rule governing private corporations, 354.
- application of, to associations of *quasi*-public corporations, 365.
- application of, to associations of dealers, 362.
- application of, to associations of manufacturers, 360.
- application of, to associations of manufacturers owning patents, 361.
- application of, to associations of railroad companies, 363, 364.
- application of, to associations of producers, 360.
- basis of, in judicial decisions, 341.
- basis of, case of Biscuit Combination, 349.
- basis of, case of the Chicago Gas Trust, 346.
- basis of, case of the Diamond Match Company, 347.
- basis of, case of the Glucose Combination, 348.
- basis of, case of the National Lead Trust, 349.
- basis of, case of the Pocahontas Coke Company, 348 *a*.
- basis of, case of the Preservers Trust, 345.
- basis of, case of the Standard Oil Trust, 343.
- basis of, case of the Sugar Trust, 342.
- basis of, Whiskey Trust cases, 344.
- basis of, cases of associations, 349.
- conservative standards, 353.
- control of the market, 356.
- difficulty of formulating, concerning combinations, 340.
- distinction between, applicable to private and *quasi*-public corporations, 351.
- distinction between useful commodities and necessities of life, 358.
- extent of territory, 357.
- form of combination immaterial, 354.

## INDEX

### RULES OF PUBLIC POLICY — *continued*,

- in general, 350.
- necessity for, 339.
- objects and tendencies of combinations, 355.
- stated, 352.
- what are necessities of life, 358.
- what are useful commodities, 358.

(See also COMBINATIONS; PUBLIC POLICY.)

### RUNNING POWERS. (See TRACKAGE CONTRACTS.)

## S

### SALE,

- distinction between, and consolidation, 13.
- outline of relations of vendor and vendee, 3.

(See also SALES OF FRANCHISES; SALES OF PROPERTY OF PRIVATE CORPORATIONS; SALES OF PROPERTY OF QUASI-PUBLIC CORPORATIONS; SALES OF RAILROADS.)

### SALES OF FRANCHISES,

- distinction between, and sale of railroad, 142.
- legislative authority essential to, 135.
- legislative authority essential to purchase, 139.
- of corporations, 133, 134.
- of corporation, does not carry property, 142.
- of corporations, nature of, 134.
- transferability of franchise of corporate existence, 132.
- ultra vires*, 139 *a*.
- unauthorized, against public policy, 137.
- unauthorized, *ultra vires*, 136.
- unauthorized, unlawful delegation of powers, 138.

### SALES OF PROPERTY OF PRIVATE CORPORATION,

- defences to stockholders' actions to set aside, 116.
- effect of sale of entire corporate property, 117.
- for stock, constructively fraudulent, 124.
- liability of purchasing corporation for debts of vendor, 123.
- obligation of majority stockholders to minority, 114.
- of entire property by directors, 112.
- of entire property by unanimous consent, 109.
- of entire property of losing corporation by majority vote, 111.
- of entire property of prosperous corporation by majority vote, 110.
- power to purchase and sell generally, 108.
- priority of purchaser's mortgage over claims of vendor's creditors, 126.
- procedure in stockholders' actions, 115.
- ratification by stockholders of sale by directors, 113.
- remedies of creditors in case of fraudulent, 125.
- remedies of dissenting stockholders in case of invalid, 114.

## INDEX

### SALES OF PROPERTY OF PRIVATE CORPORATION — *continued*,

*ultra vires*, 129 *a.*

voidable, 114.

what action necessary to authorize, 108.

when directors are interested in vendee company, *prima facie* fraudulent, 124.

whether stock of dissenting stockholders can be appraised, 121.

(See also EXCHANGE OF CORPORATE PROPERTY FOR STOCK.)

### SALES OF PROPERTY OF QUASI-PUBLIC CORPORATIONS,

indispensable property cannot be alienated without legislative authority, 127.

surplus property, 129.

test of indispensability, 128.

*ultra vires*, 129 *a.*

### SALES OF RAILROADS,

acquiescence of stockholders in, 150.

construction of statutes, 146.

conventional and judicial, distinguished, 140.

directors have no power to authorize, 149.

distinction between, and reorganization, 141.

distinction between, and sales of franchises, 142.

do not terminate corporate existence, 152.

essential franchises pass upon sale of road, 157.

liabilities of vendor corporation after authorized sale, 154.

liabilities of vendor corporation after unauthorized sale, 155.

method of authorizing and executing, 148.

obligations of vendee in respect of vendor's public duties, 162.

of road alone carries necessary franchises, 142.

remedies of dissenting stockholders in case of invalid, 151.

remedies of State in case of unauthorized, 156.

rights of vendee corporation in general, 158.

rights of vendor corporation after sale, 153.

seller must have authority to sell and buyer to buy, 144.

*status* of foreign purchasing corporation, 164.

statutes authorizing, 145.

statutes authorizing, strictly construed, 146.

statutory authority necessary to, 143.

statutory requisites for authorization and execution, 148.

stockholders may be estopped from questioning validity of, 150.

to competing or parallel line prohibited, 147.

vendee not liable for debts of vendor, 163.

whether approval of majority is sufficient in absence of statute, 149.

whether chartered rates of fare follow the property, 161.

whether exemptions from taxation pass to vendee corporation, 160.

whether right of eminent domain passes to vendee, 159.

whether sale of railroad carries franchises, 142.

## INDEX

### SECRET PROCESSES,

- application of federal anti-trust statute to combinations under, 401.
- SECURITY, whether majority can effect consolidation upon giving, 50.

(See APPRAISAL.)

### SHERMAN LAW. (See FEDERAL ANTI-TRUST STATUTE.)

### SPECIFIC PERFORMANCE, of trackage contracts, 260.

### SOUTH CAROLINA,

#### (a) *Consolidation.*

constitutional provision against consolidation of competing corporations, 32 n.

statutes authorizing consolidation of railroads, 22 n.

statutes prescribing method of consolidating, 52 n.

statute providing that consolidated corporation shall acquire no extraordinary powers, 77 n.

#### (b) *Sales.*

statutes authorizing purchase of railroads, 145 n.

#### (c) *Leases.*

statute authorizing railroad leases, 145 n, 180 n.

#### (d) *Stockholding.*

statutes authorizing corporate stockholding, 271 n.

#### (e) *Combinations.*

anti-trust statute, 414 n.

### SOUTH DAKOTA,

#### (a) *Consolidation,*

statute authorizing consolidation of railroads, 22 n.

statute prescribing method of consolidating, 52 n.

#### (b) *Sales.*

statute authorizing sales of railroads, 145 n.

statute prescribing method of authorizing sale of railroad, 148 n.

#### (c) *Leases.*

statute authorizing railroad leases, 145 n, 180 n.

statute concerning taxation of leased railroad, 224 n.

statute prescribing method of adopting railroad lease, 193 n.

statute relating to foreign lessee corporations, 254 n.

#### (d) *Stockholding.*

statute authorizing corporate stockholding, 271 n.

#### (e) *Combinations.*

anti-trust statutes, 414 n.

constitutional provision against monopolies and trusts, 414 n.

### STANDARD OIL TRUST, nature and formation of, 343.

### STATE,

#### (a) *Consolidation.*

may attack irregular consolidation, 95.

status of corporation created by joint legislative action, 101 n.

#### (b) *Leases.*

remedies of, in cases of *ultra vires* leases, 250.

STATE — *continued*,

(c) *Sales*.

remedies of, in case of unauthorized sale of railroad, 156.

(d) *Stockholding*.

remedies of, in case of *ultra vires* stockholding, 293.

(e) *Combinations*.

federal anti-trust statute inapplicable to regulations of, 403.

outline of power of, over combinations, 414.

power of, over property devoted to public uses, 417.

power of, to prohibit combinations of corporations in exercise of reserved power, 418.

power of, to prohibit combinations of *quasi*-public corporations, 417.

remedies of, in case of unlawful combinations, 372, 373, 374.

(See also QUO WARRANTO.)

STATE ANTI-TRUST STATUTES,

applicability of, to foreign corporations, 436.

application of miscellaneous, 444.

application of, to insurance combinations, 435.

apply to continuing combinations, 443.

as defence to actions for recovery of debt, 445.

civil remedies under, 449.

constitutionality of, 415-424.

construction of miscellaneous, 444.

controlling propositions in determining constitutionality of, 416.

criminal proceedings under, 446.

damages recovered under, 449.

development of, 414.

enacted in exercise of police power, 420.

evidence in proceedings under, 450.

forfeitures under, 447.

have no extraterritorial effect, 437.

indictments under, 446.

invalidity of class legislation, 421.

invalidity of exemptions of anti-trust statutes, 421.

invalidity of exemptions of agricultural products, 421.

invalidity under, as a ground for collateral attack, 445.

limitations of actions, 451.

not regulations of interstate commerce, 426.

not retroactive, 443.

penalties, 446 n.

power of State over property devoted to public uses, 417.

power of State to prohibit combinations of corporations, in exercise of reserved power, 418.

power of State to prohibit combinations of *quasi*-public corporations, 417.

proceedings against corporations under, 448.

## INDEX

### STATE ANTI-TRUST STATUTES — *continued*,

- production of books under, 450.
- provisions that, may be pleaded as defence, 445.
- rule of construction of, 427.
- sphere of State legislation, 415.
- State courts' interpretation of, followed by federal courts, 423.
- summary of, 414 n.
- validity of provisions that, may be pleaded as defence, 445.
- validity of, tested by Fourteenth Amendment, 419-421.
- validity of, under state constitutional provisions, 422.
- when, may be pleaded as defence, 445.
- who may question constitutionality of, 424.

### STATUS,

- effect of interstate consolidation upon, of constituent corporations, 102.
  - of corporation as controlling stockholder, 299.
  - of foreign corporations, 101 n.
  - of foreign vendee corporation, 164.
  - of interstate consolidated corporation, 101.
- (See also CORPORATION.)

### STATUTES,

#### (a) *Consolidation.*

- against consolidation of competing or parallel railroads, 32 n.
- as to transmission of property and franchises upon consolidation, 65.
- authorizing consolidated corporations to issue mortgage bonds, 75 n.
- authorizing consolidation not regulations of interstate commerce, 19.
- authorizing consolidation, not retroactive, 20.
- authorizing consolidation of business corporations, 23 n.
- authorizing consolidation of railroads, 22 n.
- authorizing consolidated corporation to exercise right of eminent domain, 76.
- Connecticut, concerning evidence of consolidation, 91 n.
- construction of particular, authorizing consolidation, 28, 62, 63.
- construction of, prescribing method of consolidation, 54.
- effect of consolidation depends upon terms of, 59.
- enforcement of, against consolidation, 40.
- English, authorizing amalgamation, 12.
- for appraisal of stock in consolidation proceedings, 57.
- formal requirements of, for consolidation, 52.
- Minnesota, against consolidation of competing lines, 35 n.
- miscellaneous, conferring powers on consolidated corporation, 77 n.
- New York, concerning effect of consolidation upon pending suits, 89 n.

STATUTES — *continued*,

- prescribing obligations of consolidated corporation, 79 n.
- prohibiting consolidation of competing railroads have no *ex post facto* application, 32.
- relating to transmission of property and franchises, 65.
- rule of construction of, authorizing consolidation, 27.
- showing creation of distinct corporation as result of consolidation, 62.
- showing merger as result of consolidation, 63.
- (b) *Sales*.
  - against purchase of competing or parallel railroads, 147.
  - authorizing purchases of railroads, 145.
  - authorizing sales of railroads, 145.
  - construction of, relating to sales of railroads, 146.
  - defining *status* of corporation purchasing railroad, 158.
  - for appraisal of stock in case of exchange, 121.
  - Pennsylvania, concerning dissolution of vendor corporation, 152 n.
  - prescribing method of authorizing and executing sales of railroads, 148.
  - providing that corporation purchasing railroad may exercise right of eminent domain, 159 n.
  - providing that sale of railroad shall not affect creditors, 163 n.
- (c) *Leases*.
  - authorizing leases of railroads, 180.
  - authorizing lessee to exercise power of eminent domain in name of lessor, 210 n.
  - authorizing lessee to exercise right of eminent domain, 210 n.
  - authorizing railroad leases, rule of construction of, 181.
  - compelling railroads to make track connections, 255.
  - concerning taxation of leased railroads, 224 n.
  - construction of, authorizing railroad leases, 182.
  - construction of, not authorizing railroad leases, 183.
  - imposing liability upon lessee, 230 n.
  - prescribing method of adopting lease of railroads, 193.
  - prohibiting leases of competing or parallel railroads, 186.
  - providing that railroad lease shall not affect public obligations of lessor, 215.
  - relating to foreign lessee corporations, 254.
- (d) *Stockholding*.
  - authorizing corporate stockholding, 271.
- (e) *Combinations*.
  - authorizing issue of stock of property, 319 n.
  - concerning pools, 364 n.
  - federal anti-trust statute, 376 n.
  - interstate commerce act concerning connecting lines, 363 n.
  - invalid exemptions in State anti-trust, 421.



## INDEX

### STATUTES — *continued*,

providing that anti-trust, may be pleaded in defence, 445.

State anti-trust, 414 n.

### STATUTES OF LIMITATION. (See LIMITATIONS.)

### STATUTORY AUTHORITY. (See LEGISLATIVE AUTHORITY.)

### STOCK,

#### (a) *Consolidation.*

appraisal of, 57.

condemnation of, for purposes of consolidation, 51.

#### (b) *Sales.*

appraisal of, of dissenting stockholder in case of exchange, 121.

English statute for appraisal of, 121 n.

exchange of corporate property for, *ultra vires*, 119.

exchange of property for, infringement of rights of dissenting stockholders, 120.

received upon exchange belongs primarily to corporation, 122.

reorganization plan involving payment of money in lieu of, 120.

transfer of entire corporate property for, requires unanimous consent, 118.

#### (c) *Stockholding.*

assumption of power to hold, in articles of association, 270.

English rule as to necessity for statutory authority to purchase, 265.

expediency of purchase of, immaterial, 269.

power of corporation to acquire and hold its own, 283 *a*.

rule requiring statutory authority for corporate subscriptions or purchases not evaded by indirection, 267.

similar nature of corporations does not affect power to hold, 268.

statutory authority necessary for corporation to purchase, 264.

statutory authority necessary to subscribe for, 266.

#### (d) *Combinations.*

issue of, for good-will in formation of corporate combination, 320.

issue of, for property in formation of corporate combination, 319.

(See also CORPORATE STOCKHOLDING; STOCKHOLDERS.)

### STOCKHOLDERS,

#### (a) *Consolidation.*

assent of, to consolidation, how manifested, 45.

condemnation of stock of, in aid of consolidation, 51.

estoppel of, of constituent corporations to deny regularity of organization of *de facto* consolidated corporation, 96.

estoppel of, of *de facto* consolidated corporation to deny regularity of organization, 96.

laches of, in restraining consolidation, 49.

of constituent corporations, effect of consolidation upon, 64.

of constituent corporations may restrain consolidation of competing railroads, 40.

STOCKHOLDERS — *continued*,

preferred, of constituents, obligations of consolidated corporation to, 81.

procedure in actions of, to restrain consolidation, 48.

requisite number of, whose consent is necessary to consolidation, 41, 42, 43.

rights and remedies of dissenting, to enjoin consolidation, 46.

statutes authorizing condemnation of stock of dissenting, in consolidation proceedings not applicable to lease, 51.

when unanimous consent is necessary to consolidation, 42.

whether majority can effect consolidation upon giving security, 50.

(b) *Sales.*

appraisal of stock of dissenting, in case of exchange, 121.

defences to actions by, to set aside sales of property, 116.

entitled to stock received upon exchange only upon distribution, 122.

estoppel of, to maintain suit to set aside sales of property, 116.

exchange of entire corporate property for stock requires unanimous consent of, 118.

exchange of property for stock infringement of rights of, 120.

franchise of corporate existence belongs to, 131.

hold consideration for fraudulent sale as trustees for creditors, 125.

laches of, as affecting right to complain of sales of property, 116.

may be estopped by participation or acquiescence from questioning validity of sale of railroad, 150.

objections to plan of paying dissenting, money in lieu of shares, 120.

procedure in actions of, to enjoin sale of corporate property, 115.

ratification by, of sale by directors, 113.

remedies of dissenting, in case of invalid sales, 114.

remedies of, in case of exchange of property for stock, 122 *b*.

remedies of, in case of invalid sale of railroad, 151.

sale of property of private corporation, defences to actions of, to prevent, 116.

when, may directly receive stock in exchange for corporate property, 122.

whether approval of majority of, sufficient in absence of statute, 149.

(c) *Leases.*

assent of, necessary to railroad lease, 188.

distinction between ratification by, and by legislature, 179.

laches of, may prevent attacking railroad lease, 192.

lease of entire property of prosperous corporation requires unanimous consent of, 166.

STOCKHOLDERS — *continued*,

may be estopped by acquiescence from attacking invalid railroad lease, 192.

remedies of, in case of unauthorized railroad lease, 191.

remedies of, to restrain lease of corporate property, 169.

rights of, when rent is payable in form of dividends, 212.

when leases by directors or majority of, can be set aside, 168.

whether approval of lease by majority of, sufficient in absence of statute, 189.

(d) *Stockholding*.

may enjoin voting of *ultra vires* holdings of stock, 288.

remedies of, in case of *ultra vires* stockholding, 293.

remedies of minority, of controlled corporation, 301.

*status* of corporations, as controlling, 299.

*status* of corporations as, 284.

(e) *Combinations*.

in formation of trust State regards acts of, as acts of corporation, 313.

remedies of, of combining corporations, 371.

(See also SUBSCRIBERS.)

SUBSCRIBERS,

action upon subscription by constituent corporation against, 69.

enforcement by consolidated corporation of obligations of, to constituent corporation, 69.

remedies of dissenting, in case of invalid consolidation, 47.

to stock of constituent corporation may attack irregular consolidation, 95.

when, bound by consolidation proceedings, 68.

when, estopped to question regularity of consolidation, 96.

(See also CONSOLIDATION; STOCKHOLDERS.)

SUBSCRIPTIONS,

conditional, enforcement of, by consolidated corporation, 69.

corporate, for stock in foreign corporations, 272.

corporate, through agents invalid, 267.

effect of *ultra vires* lease upon, 246.

necessity for statutory authority for corporate, 266.

remedies of consolidated corporations to enforce, 69.

to stock of constituent corporations pass to consolidated corporation, 68.

SUGAR TRUST, nature and formation of, 342.

SUITS. (See REMEDIES.)

SURPLUS PROPERTY,

leases of, 172.

sales of, 129.

surplus use of tracks, 172.

T

TAXATION,

- exemptions from. (See EXEMPTIONS FROM TAXATION.)
- of interstate consolidated corporation, 105.
- of leased railroads, 224.

TAXES,

- distinction between, and assessments, 205.
- covenant to pay, for sole benefit of lessor, 205.
- covenant to pay in railroad leases, 205.

TELEGRAPH COMPANIES,

- constitutional prohibitions against consolidation of competing, 39.

TELEPHONE COMPANIES,

- constitutional prohibitions against consolidation of competing, 39.

TENNESSEE,

- (a) *Consolidation.*
  - statutes authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statutes authorizing purchase of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases.*
  - statutes authorizing railroad leases, 145 n, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Combinations.*
  - anti-trust statutes, 414 n.
  - constitutional provision against monopolies, 414 n.

TERMINAL FACILITIES, meaning of phrase, 200.

TEXAS,

- (a) *Consolidation.*
  - statute authorizing consolidation of benevolent, etc., corporations, 23 n.
  - statute concerning consolidation of railroads, 22 n.
  - constitutional provision against consolidation of competing corporations, 32 n.
- (b) *Leases.*
  - constitutional provision against consolidation not construed to authorize lease, 183.
  - statute authorizing railroad leases, 180 n.
  - statute providing that lease shall not affect lessor's public obligation, 215.
  - statute providing that lessor shall be liable as if operating railroad, 216 n.
- (c) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.

TEXAS — *continued*,

(d) *Combinations*.

- anti-trust statutes, 414 n.
- constitutional provision against monopolies, 414 n.
- constitutionality of anti-trust statutes, 420.

TORTS,

- liability of consolidated corporation for, of constituents, 82.
- liability of lessor for, of lessee, 218-221.

(See also CONSOLIDATION; LESSEE CORPORATION; LESSOR CORPORATION; NEGLIGENCE.)

TRACKAGE CONTRACTS,

- assignability of, 258.
- construction of, 259.
- distinction between, and leases, 176, 255.
- English statutes granting running powers, 255.
- execution of, 256, 257.
- limitations upon power to execute, 256.
- liability of licensee company to employees, 263.
- liability of licensee company to third persons, 262.
- liability of proprietary company to employees, 263.
- liability of proprietary company to third persons, 261.
- nature of, 255.
- nature of running powers, 255.
- specific performance of, 260.
- statutory authority not necessary for execution of, 256.
- whether written contract is necessary, 257.

TRAFFIC CONTRACTS.

(See ASSOCIATIONS OF RAILROAD COMPANIES.)

TRANSMITTING COMPANIES,

- constitutional prohibitions against consolidation of competing, 39.

TRANSPORTATION COMPANIES,

- constitutional prohibitions against consolidation of competing, 39.

TRUST,

- definition of, 304.
- formation of, 309.
- in formation of, State regards acts of stockholders as acts of corporation, 313.
- invalid as delegating corporate powers, 315.
- invalid as involving partnership of corporations, 314.
- invalid as involving practical consolidation, 316
- nature of trust certificates, 317.
- popular use of word, 305.
- rights and liabilities of trustees, 317.
- right of trustee, 317.
- transferability of certificates, 317.

(See also COMBINATIONS.)

TRUST CERTIFICATES,

- nature of, 317.
- State anti-trust statutes concerning, 414 n.
- transferability of, 317.

TRUST FUND DOCTRINE,

- development of, 123 n.
- limitations upon, 123 n.
- objections to, 123 n.
- stated, 123 n.

TRUSTEES,

- rights and liabilities of, under industrial trusts, 317.

U

ULTRA VIRES,

- consolidation without legislative authority is, 17.
- contracts for purchase of stock, 290.
- defence of, after delivery of possession under lease, 241.
- defence of, to enforcement of leases, 240.
- distinction between acts, the majority and, the corporation, 151.
- effect of execution of, contract for exchange of property for stock, 122 a.
- exchange of property for stock is, 119.
- holdings of stock, independent contracts, 291.
- holdings of stock, liability for assessments upon, 289.
- holdings of stock, what incidents of ownership attach to, 288.
- purchase for control without express authority is, 298.
- sale of railroad, remedies of dissenting stockholders in case of, 151.
- sales of franchises, 139 a.
- unauthorized lease of railroad is, 177.
- unauthorized sale of franchises is, 136.
- unauthorized taking of lease is, 178.

ULTRA VIRES LEASES,

- distinction between, and irregular, 239.
- effect of delivery of possession under, 241.
- effect of, upon stock subscriptions, 246.
- enforcement of executory, 240.
- guarantee of, void, 247.
- lessee may surrender, without liability, 241.
- obligations of parties after disaffirmance, 242.
- quo warranto* in case of, 250.
- recovery of property after disaffirmance by lessee, 243.
- recovery on *quantum meruit* after disaffirmance, 244.
- remedy of State by injunction in case of, 251.
- right and duty of disaffirmance, 242.
- right of lessee to disaffirm, 242.
- right of lessor to disaffirm, 242.

## INDEX

### ULTR VIRES LEASES — *continued*,

- whether lessee can recover for improvements made under, 245.
- whether lessor can recover property when it disaffirms, 242.

(See also LEASES OF RAILROADS.)

### UNANIMOUS CONSENT,

- exchange of entire corporate property for stock requires, 118.
- lease of entire property of prosperous corporation requires, 166.
- sale of entire corporate property by, 109.
- when necessary to consolidation, 42.
- whether, necessary for lease of railroad, in absence of statute, 189.
- whether, necessary for sale of railroad, in absence of statute, 149.

(See also MAJORITY; MINORITY.)

### UNAUTHORIZED LEASE.

(See LEASES OF RAILROADS; LESSEE CORPORATION; LESSOR CORPORATION.)

### UNIVERSITATIS JURIS, meaning of phrase, 10.

### UNREASONABLE RESTRAINT OF TRADE,

- federal anti-trust statute not limited to contracts in, 388.

### USEFUL COMMODITIES,

- use of phrase, 350, 351, 358.
- what are, 358.

### UTAH,

#### (a) *Consolidation.*

- constitutional provision against consolidation of competing corporations, 32 n.
- statute authorizing consolidation of business corporations, 23 n.
- statute authorizing consolidation of railroads, 22 n.
- statutes prescribing method of consolidating, 52 n.

#### (b) *Sales.*

- statutes authorizing sales of railroads, 145 n.
- statute conferring powers on corporation purchasing railroads, 158 n.

#### (c) *Leases.*

- statutes authorizing railroad leases, 145 n, 180 n.

#### (d) *Stockholding.*

- statutes authorizing corporate stockholding, 271 n.

#### (e) *Combinations.*

- anti-trust statutes, 414 n.
- constitutional provision against combinations, 414 n.

## V

### VENDEE CORPORATION,

- acquires essential franchises upon purchase of railroad, 157.
- generally not liable for debts of vendor, 123.
- may assume debts of vendor, 123.
- may assume obligations of vendor, 163.
- may be made liable by statute for debts of vendor, 163.

## INDEX

### VENDEE CORPORATION — *continued*,

- mortgage of, takes priority over claims of vendor's creditors, 126.
- not liable for debts of vendor unless assumed or imposed by law, 163.
- obligations of, in respect of vendor's public duties, 162.
- rights of, in general, 158.
- statutes defining *status* of, 158.
- status* of foreign, 164.
- whether, acquires exemptions from taxation upon purchase of railroad, 160.
- whether, acquires right of eminent domain upon purchase of railroad, 159.
- whether, acquires vendor's right to fix rates of fares, 161.

### VENDOR CORPORATION,

- liabilities of, after authorized sale of railroad, 154.
- liabilities of, after unauthorized sale of railroad, 155.
- liability of vendee for debts of, 123.
- mortgage of vendee takes priority over claims of creditors of, 126.
- obligations of, not assumed by vendee upon sale of railroad, 163.
- obligations of vendee in respect of public duties of, 162.
- power of, to sell property for stock, 322.
- powers of, after sale of railroad, 153.
- quo warranto* against, in case of unauthorized sale of railroad, 156.
- sale of railroad does not terminate corporate existence of, 152.
- vendee may assume debts of, 123.
- vendee may be liable by statute for debts of, 163.
- vendee may expressly assume obligations of, 163.

### VENDOR AND VENDEE,

- outline of relations of, 3.
- distinction between relation of, and other intercorporate relations, 141.

### VERMONT,

- (a) *Consolidation*.
  - statute authorizing consolidation of railroads, 22 n.
- (b) *Leases*.
  - statute authorizing railroad leases, 180 n.
- (c) *Stockholding*.
  - statutes authorizing corporate stockholding, 271 n.

### VESTED RIGHTS,

- legislation cannot affect, 26, 266.
- power to consolidate not a, 24.

### VIRGINIA,

- statutes authorizing corporate stockholding, 271 n.

### VOIDABLE LEASES,

- may become valid by acquiescence, 248.
- of private corporation, 168.
- of railroads, 248.

(See also LEASES OF RAILROADS.)

### VOID RESTRICTIONS, in railroad leases, 220.



## INDEX

### W

#### WASHINGTON,

- (a) *Consolidation.*
  - constitutional provision against consolidation of competing corporations, 32 n.
  - statute authorizing consolidation of railroads, 22 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statute authorizing purchase of railroads, 145 n.
- (c) *Leases.*
  - statute authorizing railroad leases, 145 n, 180 n.
- (d) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations.*
  - constitutional provision against monopolies and trusts, 414 n.

#### WEST VIRGINIA,

- (a) *Consolidation.*
  - constitutional provision against consolidation of competing corporations, 32 n.
  - statutes authorizing consolidation of railroads, 22 n.
  - statutes prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statutes authorizing purchase of railroads, 145 n.
  - statute prescribing method of authorizing sale of railroad, 148 n.
- (c) *Leases.*
  - statutes authorizing railroad leases, 180 n.
  - statute prescribing method of adopting railroad lease, 193 n.
- (d) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.

#### WHISKEY TRUST, nature and formation of, 344.

#### WISCONSIN,

- (a) *Consolidation.*
  - statute authorizing consolidation of railroads, 22 n.
  - statute providing that land grants pass to consolidated corporation, 77 n.
  - statute prescribing method of consolidating, 52 n.
- (b) *Sales.*
  - statute authorizing sales of railroads, 145 n.
  - statute conferring powers on corporation purchasing railroad, 158 n.
- (c) *Leases.*
  - statute authorizing railroad leases, 145 n, 180 n.
- (d) *Stockholding.*
  - statutes authorizing corporate stockholding, 271 n.
- (e) *Combinations.*
  - anti-trust statute, 414 n.

WILSON TARIFF ACT,

provisions of, supplementing federal anti-trust statute, 383.

WORDS AND PHRASES. (See DEFINITIONS.)

WYOMING,

(a) *Consolidation.*

constitutional provision against consolidation of competing corporations, 32 n.

statutes authorizing consolidation of railroads, 22 n.

statutes prescribing method of consolidating, 52 n.

(b) *Sales.*

statute authorizing sales of railroads, 145 n.

statute prescribing method of authorizing sale of railroad, 148 n.

(c) *Leases.*

statute authorizing lessee to exercise right of eminent domain, 210 n.

statute authorizing railroad leases, 145 n, 180 n.

statute concerning taxation of leased railroad, 224 n.

statute prescribing method of adopting railroad lease, 193 n.

statute relating to foreign lessee corporations, 254 n.

(d) *Stockholding.*

statutes authorizing corporate stockholding, 271 n.

(e) *Combinations.*

constitutional provision against consolidations or combinations, 414 n.

constitutional provision against monopolies, 414 n.





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